Bulletin No. 1996–31
July 29, 1996

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 96–35, page 4.
Low-income housing tax credit. Assistance provided by the Federal Emergency Management Agency to the owner of property that is damaged by a disaster will not result in a reduction of the eligible basis of the property under section 42(d)(5), or the recharacterization of the property under section 42(i)(2) as federally subsidized.

T.D. 8678, page 11.
CO–25–96, page 30.
Temporary and proposed regulations under section 1502 of the Code relate to the limitations on net operating loss carryforwards and certain built-in losses and credits following an ownership change. A public hearing on the proposed regulations will be held on October 17, 1996.

T.D. 8679, page 4.
CO–26–96, page 31.
Final, temporary, and proposed regulations under section 382 of the Code relate to limitations on net operating loss carryforwards and certain built-in losses following an ownership change in short taxable years and with respect to controlled groups. A public hearing on the proposed regulations will be held on October 17, 1996.

FI–28–96, page 33.
Proposed regulations under section 148 of the Code relate to the arbitrage restrictions applicable to tax-exempt bonds issued by state and local governments. A public hearing will be held on October 24, 1996.

FI–48–95, page 36.
Proposed regulations under section 171 of the Code relate to the federal tax treatment of bond premium and bond issuance premium. A public hearing will be held on October 23, 1996.

EMPLOYEE PLANS

Notice 96–38, page 29.
Guidelines are set forth for determining for July 1996 the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for purposes of the full funding limitation of section 412(c)(7) of the Code as amended by the Omnibus Budget Reconciliation Act of 1987 and by the Uruguay Round Agreements Act (GATT).

EXEMPT ORGANIZATIONS

Announcement 96–68, page 45.
A list is given of organizations now classified as private foundations.

ADMINISTRATIVE

Notice 96–37, page 29.
This notice explains the procedure for claiming a refund based on *United States v. IBM*, 64 U.S.L.W. 4419 (1996).

Finding Lists begin on page 49.
Announcement of Disbarments and Suspensions begins on page 47.

Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is ''protecting the revenue.'' The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

For sale by the Superintendent of Documents U.S. Government Printing Office, Washington, D.C. 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

Low-income housing tax credit. Assistance provided by the Federal Emergency Management Agency to the owner of property that is damaged by a disaster will not result in a reduction of the eligible basis of the property under section 42(d)(5), or the recharacterization of the property under section 42(i)(2) as federally subsidized.

Rev. Rul. 96–35

ISSUES

(1) If a qualified low-income building is damaged by a disaster and a below-market loan is provided by the Federal Emergency Management Agency (FEMA) to the owner of the building to repair, reconstruct, or restore the building to its pre-casualty condition, does the loan cause the building to be characterized as federally subsidized under § 42(i)(2) of the Internal Revenue Code?

(2) If a qualified low-income building is damaged by a disaster and a grant is provided by FEMA to the owner of the building to repair, reconstruct, or restore the building to its pre-casualty condition, does the grant require the owner to reduce the building's eligible basis under § 42(d)(5) to the extent of the FEMA grant?

FACTS

Taxpayer, *T*, owns and operates a new qualified low-income building (as defined in § 42(c)(2)) that qualified for the 70-percent present value credit under § 42(b)(2)(B)(i). The building was partially destroyed by a hurricane during the building's 15-year compliance period (as defined in § 42(i)(1)). The President declared the area affected by the hurricane a major disaster area, making available assistance through FEMA. *T* received a FEMA below-market loan and a grant that *T* used to restore the building to its pre-casualty condition.

LAW AND ANALYSIS

Section 42 provides a tax credit for investment in qualified low-income buildings placed in service after December 31, 1986. For any taxable year in a 10-year credit period, the amount of credit is equal to the applicable percentage of the qualified basis of each qualified low-income building.

For a qualified low-income building placed in service after 1987, the term ''applicable percentage'' means the percentage that will yield over a 10-year period amounts of credit that have a present value equal to: (i) 70 percent of the qualified basis of new buildings that are not federally subsidized for the taxable year (70-percent present value credit), and (ii) 30 percent of the qualified basis of existing buildings, and of new buildings that are federally subsidized for the taxable year (30-percent present value credit).

Under § 42(i)(2)(A), a new building is federally subsidized for any taxable year if, at any time during the taxable year or any prior taxable year, there is or was outstanding any below-market federal loan, the proceeds of which were used (directly or indirectly) for the building or its operation.

Under § 42(c), the qualified basis of any qualified low-income building for any taxable year is an amount equal to the applicable fraction (defined in § 42(c)(1)(B)) of the eligible basis of the building. Section 42(d)(5) provides that if, during any taxable year of the compliance period, a federal grant is used for a building or its operation, the eligible basis of the building for the taxable year and all succeeding taxable years is reduced to the extent of the federal grant.

The rules of § 42(i)(2) and § 42(d)(5) limit the low-income housing credit if federally subsidized loans or federal grants are used to finance a building or meet the operating costs of the building. If a building is damaged in a federally declared disaster, however, FEMA assistance does not substitute for funds that were used to determine the building's basis nor is it used to meet operating costs of the building. Rather, FEMA funds merely help to restore the status of the building to its pre-casualty condition. FEMA funds provide no additional federal benefit to taxpayers that § 42(i)(2) and § 42(d)(5) were intended to limit. Furthermore, reducing the amount of the credit available under § 42 would place the owner of a qualified low-income building at a disadvantage compared with other building owners using FEMA funds. Therefore, the amount of credit available to a building will not be affected under § 42(i)(2) and § 42(d)(5) by the building owner's use of FEMA assistance.

HOLDING

(1) A below-market loan provided by FEMA to the owner of a qualified low-income building damaged by a disaster to repair, reconstruct, or restore the building to its pre-casualty condition does not result in characterizing the building as federally subsidized under § 42(i)(2).

(2) A grant provided by FEMA to the owner of a qualified low-income housing building damaged by a disaster does not cause a reduction of the building's eligible basis under § 42(d)(5) to the extent that the grant funds are used to repair, reconstruct, or restore the building to its pre-casualty condition.

DRAFTING INFORMATION

The principal author of this revenue ruling is Christopher J. Wilson of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Mr. Wilson on (202) 622–3040 (not a toll-free call).

Section 382.—Limitations on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

26 CFR 1.382–8T: Controlled groups (temporary).

T.D. 8679

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Regulations Under Section 382 of the Internal Revenue Code of 1986; Application of Section 382 in Short Taxable Years and With Respect to Controlled Groups

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations relating to limitations on net operating loss carryforwards and certain built-in losses following an ownership change and comply with the statutory direction under section 382(m) of the Internal Revenue Code to prescribe regulations concerning short taxable years and controlled groups. This document also contains amendments relating to the end of separate tracking of the stock ownership of loss corporations that cease to exist following a merger or similar transaction. The text of these temporary

regulations also serves as the text of the proposed regulations set forth in CO–26–96, page 31, in this issue of the Bulletin.

DATES: These regulations are effective Thursday, June 27, 1996.

For dates of application and special transition rules, see Effective Dates under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CONTACT: David B. Friedel at (202) 622– 7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these temporary regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under the control number 1545– 1434. Section 1.382–8T(h) requires a response from certain corporations that are members of controlled groups. The IRS requires this information to assure compliance with section 382(m)(5) so that the value of a loss corporation that is a member of a controlled group is not taken into account more than once in computing a section 382 limitation. Responses to this collection of information are required to obtain a benefit (relating to the restoration of value for section 382 purposes).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to CO–26–96, page 31, in this issue of the Bulletin.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

On February 4, 1991, the IRS and Treasury issued three notices of proposed rulemaking, CO–132–87 (56 FR 4194), CO–077–90 (56 FR 4183), and CO–078–90 (56 FR 4228), setting forth rules regarding the application of sections 382 and 383 by consolidated groups and by controlled groups, and the carryover and carryback of losses to consolidated and separate return years.

For reasons explained in the preamble to TD 8678 (page 11 in this issue of the Bulletin), the IRS and Treasury are issuing temporary amendments concerning the limitations on net operating loss carryforwards and certain built-in losses and credits following an ownership change of a consolidated group. The temporary regulations contained in this Treasury decision complement those other temporary regulations. They assure that the members of a controlled group cannot duplicate value in computing their respective section 382 limitations, a result not permitted to members of a group filing consolidated returns. See § 1.1502–93T.

These temporary regulations are substantially identical to the rules proposed on January 29, 1991. One provision (relating to the effects of successive ownership changes) was moved from the consolidated return regulations to the section 382 regulations to clarify that it is applicable to all corporations. These temporary amendments do not address the numerous comments on the proposed regulations. Many of these comments are still under consideration.

Effective Dates

The temporary amendments are generally effective as of January 1, 1997. The final rules relating to the value of stock added to § 1.382–2(a)(3)(i) and the temporary rules in § 1.382–2T(f)(1)(ii) (relating to the end of separate tracking of certain loss corporations) are generally effective as of January 29, 1991. The temporary rules in § 1.382–5T (relating generally to short taxable years and successive ownership changes) generally apply to loss corporations that have an ownership change to which section 382(a), as amended by the Tax Reform Act of 1986, applies.

Special Analysis

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations were sent to the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of the temporary regulations is David B. Friedel of the Office of Assistant Chief Counsel (Corporate), IRS. Other personnel from the IRS and Treasury participated in their development.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for Part 1 is amended by removing the entries for ''1.382–2'' and ''1.382–2T'' and adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.382–2 also issued under 26 U.S.C. 382(k)(1), (l)(3), (m), and 26 U.S.C. 383.

Section 1.382–2T also issued under 26 U.S.C. 382(g)(4)(C), (i), (k)(1) and (6), (l)(3), (m), and 26 U.S.C. 383.* * *

Section 1.382–5T also issued under 26 U.S.C. 382(m).* * *

Section 1.382–8T also issued under 26 U.S.C. 382(m).* * *

Par. 2. Section 1.382–1 is amended by:

a. Adding an entry for § 1.382–2, paragraph (a)(1)(iv).

b. Revising the entry for § 1.382–2, paragraph (a)(3)(i).

c. Adding entries for § 1.382–2T, paragraphs (f)(1)(i) through (f)(1)(iii).

d. Adding entries for §§ 1.382–5T and 1.382–8T.

§ 1.382–1 Table of contents.

* * * * *

§ 1.382–2 General rules for ownership change.

(a) * * *

(1) * * *

(iv) End of separate accounting for losses and credits of distributor or transferor loss corporation.

* * * * *

§ 1.382–2T Definition of ownership change under section 382, as amended by the Tax Reform Act of 1986 (temporary).

* * * * *

(f) * * *

(1) * * *

(i) In general.

(ii) End of separate accounting for losses and credits of distributor or transferor loss corporation.

(iii) Application to other successor corporations.

* * * * *

§ 1.382–5T Section 382 limitation (temporary).

(a) Scope.

(b) Computation of value.

(c) Short taxable year.

(d) Successive ownership changes and absorption of a section 382 limitation.

(1) In general.

(2) Recognized built-in gains and losses.

(3) Effective date.

(e) Controlled groups.

(f) Effective date.

* * * * *

§ 1.382–8T Controlled groups (temporary).

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(b) Controlled group loss and controlled group with respect to a controlled group loss.

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(h) Time and manner of filing election to restore.

(1) Statement required.

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(3) Filing by component member.

(i) [Reserved]

(j) Effective date.

(1) In general.

(2) Transition rule.

(i) In general.

(ii) Special transition rules for controlled groups that had ownership changes before January 29, 1991.

(3) Amended returns.

Par. 3. Section 1.382–2 is amended as follows:

a The first sentence of paragraph (a)(1)(iii) is amended by removing the language ''Pre-change losses'' and adding ''Except as provided in § 1.382–2T(f)(1)(ii), pre-change losses'' in its place.

b Paragraph (a)(1)(iv) is added.

c The text of § 1.382–2T(f)(18)(i) is redesignated as the text of § 1.382–2(a)(3)(i).

d Newly designated paragraph (a)(3)(i) is amended by adding three sentences at the end.

The additions read as follows:

§ 1.382–2 General rules for ownership change.

(a) * * *

(1) * * *

(iv) *End of separate accounting for losses and credits of distributor or transferor loss corporation.* For further guidance, see § 1.382–2T(f)(1)(ii).

* * * * *

(3) * * * (i) * * * Solely for purposes of determining the percentage of stock owned by a person, each share of all the outstanding shares of stock that have the same material terms is treated as having the same value. Thus, for example, a control premium or blockage discount is disregarded in determining the percentage of stock owned by any person. The previous two sentences of this paragraph (a)(3)(i) apply to any testing date occurring on or after January 29, 1991.

* * * * *

Par. 4. Section 1.382–2T is amended as follows:

(a) Paragraph (e)(2)(iv) *Example (1)* is amended by removing the last sentence.

(b) Paragraph (e)(2)(iv) *Example (2)(ii)* is amended by adding a sentence at the end.

(c) Paragraph (e)(2)(iv) *Example (2)(iii)* is amended by removing the language '', but must be separately accounted for under § 1.382–2(a)(1)(iii) of this section'' from the last sentence.

(d) The text following the heading of paragraph (f)(1) is designated as paragraph (f)(1)(i) and a heading for newly designated paragraph (f)(1)(i) is added.

(e) Paragraphs (f)(1)(ii) and (f)(1)(iii) are added.

(f) Paragraph (f)(4) is amended by removing the word ''loss'' and by adding two sentences at the end.

(g) Paragraph (f)(5) is amended by adding two sentences at the end.

(h) A sentence is added after the heading of paragraph (f)(18)(i).

(i) Paragraph (h)(2)(i)(A) is amended by adding the language ''and solely for the purposes of determining whether a loss corporation has an ownership change'' immediately after ''except as otherwise provided in this section,''.

The additions read as follows:

§ 1.382–2T Definitions of ownership change under section 382, as amended by the Tax Reform Act of 1986 (temporary).

* * * * *

(e) * * *

(2) * * *

(iv) * * *

Example (2) * * *

(ii) * * * See paragraph (f)(1)(ii) of this section for rules that end separate accounting for L_1's pre-change losses on any testing date occurring on or after January 29, 1991.

(f) * * *

(1) * * *

(i) *In general.* * * *

(ii) *End of separate accounting for losses and credits of distributor or transferor loss corporation.* The separate tracking of owner shifts of the stock of an acquiring corporation required by § 1.382–2(a)(1)(iii) with respect to the net operating loss carryovers and other attributes described in § 1.382–2(a)(1)(ii) ends when a fold-in event occurs. A fold-in event is either an ownership change of the distributor or transferor corporation in connection with, or after, the transaction to which section 381(a) applies, or a period of 5 consecutive years following the section 381(a) transaction during which the distributor or transferor corporation has not had an ownership change. Starting on the day after the earlier of the change date (but not earlier than the day of the section 381(a) transaction) or the last day of the 5 consecutive year period, the losses and other attributes of the distributor or transferor corporation are

treated as losses and attributes of the acquiring corporation for purposes of determining whether an ownership change occurs with respect to such losses. Also, for purposes of determining the beginning of the acquiring corporation's testing period, such losses are considered to arise either in a taxable year that begins not earlier than the later of the day following the change date or the day of the section 381(a) transaction, or in a taxable year that begins 3 years before the end of the 5 consecutive year period. Pre-change losses of a distributor or transferor corporation that are subject to a limitation under section 382 continue to be subject to the limitation notwithstanding the occurrence of a fold-in event. Any ownership change that occurs in connection with, or subsequent to, the section 381 transaction may result in an additional, lesser limitation with respect to such pre-change losses. This paragraph (f)(1)(ii) applies to any testing date occurring on or after January 29, 1991.

(iii) *Application to other successor corporations.* Section 1.382–2(a)(1) (relating to the definition of loss corporation) and this paragraph (f)(1) also apply, as the context may require, to successor corporations other than successors in section 381(a) transactions. For example, if a corporation receives assets from the loss corporation that have basis in excess of value, the recipient corporation's basis for the assets is determined, directly or indirectly, in whole or in part, by reference to the loss corporation's basis, and the amount by which basis exceeds value is material, the recipient corporation is a successor corporation subject to § 1.382–2(a)(1) and this paragraph (f)(1). This paragraph (f)(1)(iii) applies to any testing date occurring on or after January 1, 1997.

* * * * *

(4) *Successor corporation.* * * * A successor corporation also includes, as the context may require, a corporation which receives an asset or assets from another corporation if the corporation's basis for the asset(s) is determined, directly or indirectly, in whole or in part, by reference to the other corporation's basis and the amount by which basis differs from value is, in the aggregate, material. The previous sentence of this paragraph (f)(4) applies to any testing date occurring on or after January 1, 1997.

(5) *Predecessor corporation.* * * * A predecessor corporation also includes, as the context may require, a corporation which transfers an asset or assets to another corporation if the transferee's basis for the asset(s) is determined, directly or indirectly, in whole or in part, by reference to the corporation's basis and the amount by which basis differs from value is, in the aggregate, material. The previous sentence of this paragraph (f)(5) applies to any testing date occurring on or after January 1, 1997.

* * * * *

(18) * * * (i) * * * For further guidance, see § 1.382–2(a)(3)(i).

* * * * *

Par. 5. Sections 1.382–5T and 1.382–8T are added to read as follows:

§ 1.382–5T Section 382 limitation (temporary).

(a) *Scope.* Following an ownership change, the section 382 limitation for any post-change year is an amount equal to the value of the loss corporation multiplied by the long-term tax- exempt rate that applies with respect to the ownership change, and adjusted as required by section 382 and the regulations thereunder. See, for example, section 382(b)(2) (relating to the carryforward of unused section 382 limitation), section 382(b)(3)(B) (relating to the section 382 limitation for the post-change year that includes the change date), section 382(m)(2) (relating to short taxable years), and section 382(h) (relating to recognized built-in gains and section 338 gains).

(b) *Computation of value.* [Reserved]

(c) *Short taxable year.* The section 382 limitation for any post-change year that is less than 365 days is the amount that bears the same ratio to the section 382 limitation determined under section 382(b)(1) as the number of days in the post-change year bears to 365. The section 382 limitation, as so determined, is adjusted as required by section 382 and the regulations thereunder. This paragraph (c) does not apply to a 52–53 week taxable year that is less than 365 days unless a return is required under section 443 (relating to short periods) for such year.

(d) *Successive ownership changes and absorption of a section 382 limitation*—(1) *In general.* If a loss corporation has two (or more) ownership changes, any losses attributable to the period preceding the earlier ownership change are treated as pre-change losses with respect to both ownership changes. Thus, the later ownership change may result in a lesser (but never in a greater) section 382 limitation with respect to such losses. In any case, the amount of taxable income for any post-change year that can be offset by pre-change losses may not exceed the section 382 limitation for such ownership change, reduced by the amount of taxable income offset by pre-change losses subject to any earlier ownership change(s).

(2) *Recognized built-in gains and losses.* [Reserved]

(3) *Effective date.* This paragraph (d) applies to taxable years of a loss corporation beginning on or after January 1, 1997.

(e) *Controlled groups.* See § 1.382–8T for rules for determining the value of a loss corporation that is a member of a controlled group.

(f) *Effective date.* Except as otherwise provided, this section applies to a loss corporation that has an ownership change to which section 382(a), as amended by the Tax Reform Act of 1986, applies.

§ 1.382–8T Controlled groups (temporary).

(a) *Introduction.* This section provides rules to adjust the value of a loss corporation that is a member of a controlled group of corporations on a change date so that the same value is not included more than once in computing the limitations under section 382 for the loss corporations that are members of the controlled group. In general, the adjustment is made under paragraph (c) of this section by reducing the value of the loss corporation by the value of the stock of each component member of the controlled group that the loss corporation owns immediately after the ownership change. The loss corporation's value may, however, be increased under paragraph (c) of this section by any amount of value that the other member elects to restore to the loss corporation.

(b) *Controlled group loss and controlled group with respect to a controlled group loss.* A controlled group loss is a pre-change loss (or a net unrealized built-in loss) of a loss corporation that is attributable to a taxable year of the corporation with respect to which the corporation is a component member of a controlled group (as defined by paragraphs (e)(2) and (3) of this section). The controlled group with respect to each controlled group loss is composed of the loss corporation and each other corporation that is a compo-

nent member of a controlled group that includes the loss corporation both—

(1) With respect to the taxable year to which the controlled group loss is attributable; and

(2) On the date the loss corporation has an ownership change.

(c) *Computation of value.* For purposes of computing the limitation under section 382 with respect to each controlled group loss, the value of the stock of each component member of the controlled group with respect to that loss is determined immediately before the ownership change, and is adjusted by applying the following rules:

(1) *Reduction in value.* The value of the stock of each component member is reduced by the value (immediately before the ownership change and without regard to any restoration of value or other adjustment under this section) of the stock of any other component member directly owned by the component member immediately after the ownership change.

(2) *Restoration of value.* After the value of the stock of each component member is reduced pursuant to paragraph (c)(1) of this section, the value of the stock of each component member is increased by the amount of value, if any, restored to the component member by another component member (the electing member) pursuant to this paragraph (c)(2). The electing member may elect to restore value to another component member in an amount that does not exceed the lesser of—

(i) The sum of—

(A) The value, determined immediately before the ownership change, of the electing member's stock (after adjustment under paragraph (c)(1) of this section and before any restoration of value under this paragraph (c)(2)); plus

(B) Any amount of value restored to the electing member by another component member under this paragraph (c)(2); or

(ii) The value, determined immediately before the ownership change, of the electing member's stock (without regard to any adjustment under this section) that is directly owned by the other component member immediately after the ownership change.

(3) *Reduction in value by the amount restored.* The value of the stock of the electing member is reduced by any amount of value that the electing member elects to restore under paragraph (c)(2) of this section to another component member.

(4) *Appropriate adjustments.* Appropriate additional adjustments consistent with paragraphs (c)(1), (2), and (3) of this section must be made to prevent any duplication of value. Thus, for example, adjustments must be made to reflect—

(i) Any indirect ownership interest in another component member;

(ii) Any cross ownership of stock by component members of the controlled group with respect to the controlled group loss; and

(iii) Any value used to determine a limitation under section 382 with respect to controlled group losses from the same period.

(5) *Certain reductions in the value of members of a controlled group.* A loss corporation that has an ownership change is required to make adjustments consistent with this paragraph (c) with respect to its stock if the stock of another corporation in which it had a direct or indirect ownership interest was disposed of before the ownership change, and;

(i) Both corporations were component members of a controlled group—

(A) With respect to a taxable year to which a controlled group loss of the loss corporation is attributable; and

(B) At any time during the 2 year period before the ownership change; and

(ii) Both corporations are component members of a controlled group at any time during the 2 year period following the ownership change.

(d) *No double reduction.* To the extent consistent with the purposes of this section, section 382 and this section shall not be applied to duplicate a reduction in the value of a loss corporation. Thus, for example, if the value of a loss corporation is reduced under section 382(l)(1) to reflect a capital contribution of stock of a component member, it is not again reduced by such amount under paragraph (c)(1) of this section. If this paragraph (d) applies to prevent a reduction in value from being duplicated, the application of the other rules of this section, such as those relating to the restoration of value, is correspondingly limited in a manner consistent with the principles of this section.

(e) *Definitions and nomenclature*—(1) *Definitions in section 382 and the regulations thereunder.* Except as otherwise provided, the definitions and nomenclature contained in section 382 and the regulations thereunder apply to this section.

(2) *Controlled group.* Controlled group has the same meaning as in section 1563(a), determined by substituting ''50 percent'' for ''80 percent'' each place that it appears, and without regard to section 1563(a)(4).

(3) *Component member.* Component member has the same meaning as in section 1563(b), determined by substituting ''December 31 (or the change date, if earlier)'' for ''December 31'' each place it appears, and without regard to section 1563(b)(2), (b)(3)(C), and (b)(4).

(4) *Predecessor and successor corporation.* As the context may require, a reference to a corporation, or component member includes a reference to a predecessor or successor corporation.

(f) *Coordination between consolidated groups and controlled groups.* Some or all of the component members of a controlled group may also be members of a consolidated group, and a controlled group loss may be subject to a consolidated section 382 limitation or subgroup section 382 limitation determined under § 1.1502–93T. Except as otherwise provided in this paragraph (f) and §§ 1.1502–91T through 1.1502–99T, § 1.1502–93T applies instead of this section when both sections, by their terms, are otherwise applicable. This section is applicable and may require an adjustment to value if a member of a consolidated group, a loss group, or a loss subgroup (as those terms are defined in §§ 1.1502–1(h) and 1.1502–91T) is also a component member of a controlled group with respect to a controlled group loss. Solely for purposes of applying this section, a consolidated group, loss group, or loss subgroup is treated as a single corporation. Thus to determine the limitation with respect to any portion of the pre-change consolidated attributes or pre-change subgroup attributes of the loss group or loss subgroup that is a controlled group loss, the consolidated section 382 limitation or subgroup section 382 limitation is computed by treating the loss group or the loss subgroup as a single corporation, and adjusting value in accordance with paragraph (c) of this section. See paragraph (g) Example 4 of this section.

(g) *Examples.* For purposes of the examples in this section, unless otherwise stated, the nomenclature and assumptions of the examples in § 1.382–2T(b) apply, all corporations file separate income tax returns on a calendar year basis, the only 5-percent shareholder of a corporation is a public group, and the facts set forth the only owner shifts with respect to the corporations during the testing period.

Example 1. Controlled group with respect to a controlled group loss. (a) Public L owns all of the L stock, L and Public L1 own 30 percent and 70 percent, respectively, of the L1 stock, and L1 owns all of the corporation T stock. L1 has a net operating loss arising in Year 1 that is carried over to Year 4. L has a net operating loss arising in Year 2 that is carried over to Year 4. On August 1, Year 3, L acquires 30 percent of the stock of L1, thereby increasing its percentage ownership interest in L1 to 60 percent. On December 1, Year 3, L1 purchases all of the stock of corporation S from Public S. On November 1, Year 4, P acquires all of the L stock. The acquisition by P of all of the L stock on November 1, Year 4, causes ownership changes of both L and L1 under the rules of § 1.382–2T. The following is a graphic illustration of these facts.

(b)(1) Under paragraph (b) of this section, the Year 1 net operating loss carryover of L1 is a controlled group loss because L1 is a component member of a controlled group with respect to Year 1, the year to which the loss is attributable. L1 and T compose a controlled group with respect to the net operating loss carryover because L1 and T are component members of a controlled group both—

(A) With respect to the taxable year to which L1's net operating loss carryover is attributable (i.e., Year 1); and

(B) On November 1, Year 4, L1's change date. Although L and S are component members of L1's controlled group on L1's change date, they are not component members of the controlled group with respect to the Year 1 net operating loss carryover because they were not component members with respect to the year to which the net operating loss carryover is attributable.

(2) The value of L1's stock must therefore be adjusted in accordance with paragraph (c) of this section to take into account an adjustment with respect to the T stock (but not the S stock) in computing L1's limitation under section 382 with respect to its net operating loss carryover.

(c) Although L is a member of a controlled group composed of L, L1, S, and T on November 1, Year 4, L's change date, it is not a component member of a controlled group with respect to Year 2, the taxable year to which its net operating loss carryover is attributable. Therefore, L's Year 2 net operating loss carryover is not a controlled group loss under paragraph (b) of this section and the value of L's stock is not adjusted in accordance with paragraph (c) of this section to compute L's limitation under section 382 with respect to the Year 2 net operating loss carryover.

Example 2. Adjustments to value of the controlled group members. (a) Since Year 1, A has owned all of the stock of L, L and B have owned 80 percent and 20 percent, respectively, of the stock of corporation P, and P and C have owned 75 percent and 25 percent, respectively, of the stock of L1. L and L1 each has a net operating loss for the Year 6 taxable year that is carried over to its respective Year 7 taxable year. On December 1, Year 7, A sells all of the L stock to D. The sale results in ownership changes of both L and L1. Immediately before the ownership changes, the total value of the L1 stock is $40, the total value of the P stock (including the value of its L1 stock) is $100, and the total value of the L stock (including the value of the P stock) is $200. The following is a graphic illustration of these facts.

(b) Under paragraph (b) of this section, the Year 6 net operating loss carryovers of each of L and L1 are controlled group losses because each of L and L1 is a component member of a controlled group with respect to Year 6, the year to which the losses are attributable. L, P, and L1 compose controlled groups with respect to both Year 6 net operating loss carryovers because L, P, and L1 are component members of a controlled group both—

(1) With respect to the taxable years to which the net operating loss carryovers are attributable (i.e., Year 6); and

(2) On December 1, Year 7, the change date.

(c) The value of the stock of L1 for purposes of determining its limitation under section 382 with respect to its net operating loss carryover from Year 6 is $40. L1 does not elect to restore any value to P under paragraph (c)(2) of this section.

(d) The value of the stock of P ($100) is reduced under paragraph (c)(1) of this section by the value of the stock of L1 that it directly owns, $30 (75% x $40). Following the adjustment, the value of the stock of P is $70. P elects to restore this entire $70 of value to L.

(e) The value of the stock of L, $200, is reduced under paragraph (c)(1) of this section by the value of the stock of P it directly owns, i.e., $80 (80% x $100), and increased under paragraph (c)(2) of this section by the amount P elects to restore to L, i.e., $70. Thus, the value of the L stock for purposes of determining L's limitation under section 382 with respect to its net operating loss carryover from Year 6 is $190 ($200 − $80 + $70).

Example 3. Limitation on restoration of value. (a) The facts are the same as in *Example 2*, except that L1 elects to restore $20 to P. For purposes of determining L1's limitation under section 382 with respect to the Year 6 net operating loss carryover, the value of the stock of L1 is $20 ($40 − $20) because the value of its stock is reduced under paragraph (c)(3) of this section by the $20 of value it elects to restore to P.

(b) The value of the stock of P ($100) is reduced under paragraph (c)(1) of this section by the value of the L1 stock it directly owns ($30), and is increased under paragraph (c)(2) of this section by the value that L1 elects to restore to P ($20). Thus, the value of the P stock is $90 ($100 − $30 + $20).

(c)(1) P elects to restore to L the maximum value permitted under this section. The value of the stock of L, $200, is reduced under paragraph (c)(1) of this section by the value of the P stock it directly owns ($80), and is increased by the value that P elects to restore to L. P may elect to restore to L the lesser of—

(A) The sum of the value of its stock immediately after adjustment under paragraph (c)(1) of this section (i.e., $70) plus the value restored to it by L1 (i.e., $20) (a total of $90); or

(B) The value of the P stock (without regard to the adjustment required by paragraphs (c)(1) and (2) of this section) that is directly owned by L immediately before the ownership change (i.e., $80).

(2) Thus, $80 is the maximum amount that P may elect to restore to L. Following the restoration of value by P, the value of the L stock for purposes of determining L's limitation under section 382 is $200 ($200 − $80 + $80).

Example 4. Coordination with consolidated return regulations. (a) P and its wholly owned subsidiary L file a consolidated return. L owns 79 percent of the outstanding stock of L1. P acquired the stock of L in Year 1 and L acquired the stock of L1 in Year 2. The P consolidated group has a consolidated net operating loss arising in the Year 6 consolidated return year that is carried over to Year 8. L1 has a net operating loss arising in its Year 6 taxable year that is also carried over to Year 8. On January 1, Year 8, the P consolidated group has an ownership change under § 1.1502–92T(b)(1)(i) and L1 has an ownership change under § 1.382–2T.

(b)(1) Under paragraph (b) of this section, the Year 6 net operating loss carryover of the P group is a controlled group loss because P, L, and L1 are component members of a controlled group with respect to Year 6, the year to which the loss is

attributable. P, L, and L1 compose a controlled group with respect to the Year 6 net operating loss carryover of the P loss group because they are component members of a controlled group both—

(A) With respect to the taxable years to which the net operating loss carryover is attributable (i.e., Year 6); and

(B) On January 1, Year 8, the P group's change date. (2) Because P and L compose a loss group (within the meaning of § 1.1502–91T(c)) with respect to its Year 6 net operating loss carryover, the P loss group must compute a consolidated section 382 limitation with respect to its Year 6 net operating loss carryover as a result of the ownership change.

(c) In computing the consolidated section 382 limitation under § 1.1502–93T with respect to the Year 6 net operating loss carryover, the value of the P stock immediately before the ownership change is reduced under paragraphs (c)(1) and (f) of this section by the value immediately before the ownership change of the L1 stock directly owned by L immediately after the ownership change. L1 may, however, elect to restore such value to the P consolidated group to the extent permitted under paragraph (c)(2) of this section.

Example 5. Appropriate adjustments for indirect ownership interest. (a) Individual A owns all of the stock of L, L owns an 80 percent interest in the capital and profits of partnership PS, and PS owns 75 percent of the stock of L1. Both L and L1 have net operating losses for the Year 1 taxable year that are carried over to their respective Year 2 taxable years. On December 19, Year 2, A sells all of the L stock to an unrelated individual. The sale results in an ownership change of L and L1.

(b) Under paragraph (b) of this section, the Year 1 net operating loss carryovers of each of L and L1 are controlled group losses because each of L and L1 is a component member of a controlled group with respect to Year 1, the year to which the losses are attributable. L and L1 compose controlled groups with respect to each corporation's net operating loss carryovers because L and L1 are component members of a controlled group both—

(1) With respect to the taxable years to which the net operating loss carryovers are attributable (i.e., Year 1); and

(2) On December 19, Year 2, the change date.

(c) L has an indirect ownership interest in L1 which, under paragraph (c)(4) of this section, must be taken into account in applying this section. As a result, the value of the L stock for purposes of determining its limitation under section 382 with respect to the Year 1 net operating loss carryover must be reduced by the value of L's indirect ownership interest in the L1 stock (60 percent) that it owns through PS immediately before the ownership change, and is increased by the amount (if any) that L1 elects to restore to L under paragraph (c)(2) of this section. The value of L1 is reduced under paragraph (c)(3) of this section to the extent that L1 elects to restore value to L.

(h) *Time and manner of filing election to restore*—(1) *Statement required.* The election to restore value described in paragraph (c)(2) of this section must be in the form set forth below. It must be signed on behalf of both the electing member and the corporation to which such value is restored by persons authorized to sign their respective income tax returns. (The common parent of a consolidated group must make the election on behalf of the group.) It must be filed by the loss corporation with its income tax return for the taxable year in which the ownership change occurs (or with an amended return for such year filed on or before the due date (including extensions) of the income tax return of any component member with respect to the taxable year in which the ownership change occurs). The statement must provide that: ''THIS IS AN ELECTION UNDER § 1.382– 8T OF THE INCOME TAX REGULATIONS TO RESTORE ALL OR PART OF THE VALUE OF [insert name and E.I.N. of the electing member] TO [insert name and E.I.N. of the corporation to which value is restored]. The statement must also—

(i) Identify the change date for the loss corporation in connection with which the election is made;

(ii) State the value of the electing member's stock (without regard to any adjustment under paragraph (c) of this section) immediately before the ownership change;

(iii) State the amount of any reduction required under paragraph (c)(1) of this section with respect to stock of the electing member that is owned directly or indirectly by the corporation to which value is restored;

(iv) State the amount of value that the electing member elects to restore to the corporation; and

(v) State whether the value of either component member's stock was adjusted pursuant to paragraph (c)(4) of this section.

(2) *Revocation of election.* An election made under this section is revocable only with the consent of the Commissioner.

(3) *Filing by component member.* An electing member must attach a copy of the statement described in paragraph (h)(1) of this section to its income tax return (or amended return) for the taxable year which includes the change date in connection with which the election is made.

(i) [Reserved]

(j) *Effective date*—(1) *In general.* This section applies to a loss corporation that has an ownership change with respect to a controlled group loss on or after January 1, 1997.

(2) *Transition rule*—(i) *In general.* The members of a controlled group on January 1, 1997, that have had an ownership change with respect to a controlled group loss before January 1, 1997, must determine the limitations under section 382 for any post-change year with respect to controlled group losses by using a reasonable method to preclude the value of stock of a component member that was owned directly or indirectly by another member immediately after an ownership change from being taken into account more than once in determining the limitations under section 382 with respect to controlled group losses. If such a reasonable method was not used for a post-change year, subject to the exception in paragraph (j)(3) of this section, the members of the controlled group described in the preceding sentence must reduce their limitations under section 382 for post-change years for which the income tax return is filed after January 1, 1997, to recapture, as quickly as possible, any limitation that members took into account in excess of the amount that would be allowable under this section.

(ii) *Special transition rule for controlled groups that had ownership changes before January 29, 1991.* For purposes of this section, in the case of an ownership change occurring before January 29, 1991, the controlled group with respect to a controlled group loss does not include a corporation that is not a component member of the controlled group on January 29, 1991. Thus, in the case of an ownership change occurring before January 29, 1991, paragraph (c) of this section does not require that a loss corporation that is a component member of a controlled group to disregard the value of stock of another corporation directly owned immediately after the ownership change in determining the value of its own stock unless the other corporation is a component member of the controlled group on January 29, 1991.

(3) *Amended returns.* A taxpayer that has had an ownership change before January 1, 1997, may file an amended return for any taxable year to modify the amount of a limitation under section 382 with respect to a controlled group loss only if—

(i) The modification complies with the rules contained in this section for computing a limitation under section 382;

(ii) Any other component member of the controlled group with respect to the controlled group loss who elects to restore value and whose taxable income is affected by the election to restore value also files amended returns that comply with such rules; and

(iii) Corresponding adjustments are made in amended returns for all taxable years ending after December 31, 1986.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 6. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 7. In § 602.101, paragraph (c) is amended by adding an entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified or described	Current OMB control No.
* * * * *	
1.382.8T	1545–1434
* * * * *	

Margaret Milner Richardson,
Commissioner of Internal Revenue.
Approved May 31, 1996.

Leslie Samuels,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 26, 1996, 8:45 a.m., and published in the issue of the Federal Register for June 27, 1996, 61 F.R. 33313)

Section 1502.—Regulations

26 CFR 1.1502–91T: Application of section 382 with respect to a consolidated group (temporary).

T.D. 8678

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Regulations Under Section 1502 of the Internal Revenue Code of 1986; Limitations on Net Operating Loss Carryforwards and Certain Built-in Losses and Credits Following an Ownership Change of a Consolidated Group

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations regarding the operation of sections 382 and 383 of the Internal Revenue Code of 1986 (relating to limitations on net operating loss carryforwards and certain built-in losses and credits following an ownership change) with respect to consolidated groups. The regulations include rules for determining whether a loss group or a loss subgroup has an ownership change, for computing a consolidated section 382 limitation or subgroup section 382 limitation, and for applying sections 382 and 383 to corporations that join or leave a group. The rules are necessary to provide guidance to such groups on the use of certain of their tax attributes. The text of these temporary regulations also serves as the text of CO–25–96, page 30, in this issue of the Bulletin.

DATES: These regulations are effective Thursday, June 27, 1996.

For dates of application and special transition rules, see Effective Dates under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CONTACT: David B. Friedel at (202) 622–7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in the temporary regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under the control number 1545–1218. The collection requires a response from certain consolidated groups. The IRS requires the information described in § 1.1502–95T(e) to assure that a section 382 limitation is properly determined in cases of corporations that cease to be members of a group. Responses to this collection of information are required to obtain a benefit (relating to the section 382 limition applicable to the departing member(s)).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to CO–25–96, page 30, in of this issue of the Bulletin.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

On February 4, 1991, the IRS and Treasury issued three notices of proposed rulemaking, CO–132–87 (56 FR 4194), CO–077–90 (56 FR 4183), and CO–078–90 (56 FR 4228), setting forth rules regarding the application of sections 382 and 383 by consolidated groups and by controlled groups, and regarding the use of built-in deductions and net operating losses and capital losses, including the carryover and carryback of separate return limitation year (SRLY) losses of members of consolidated groups. The preambles to the three proposed regulations explain their rules in detail. The IRS and Treasury also published Notice 91–27 (1991–2 C.B. 629) to advise of intended modifications to the proposed regulations.

For reasons explained in the preamble to TD 8677 (published in 1996–30 I.R.B. 7), the IRS and Treasury are issuing temporary amendments concerning the use of built-in deductions and net operating losses and capital losses of members of consolidated groups. Some of the rules in those temporary amendments are closely related to rules regarding the application of section 382 to members of consolidated groups (for example, rules relating to built-in deductions and subgroups). Because of the close relationship, and in order to give consolidated groups immediate guidance on the application of sections 382 and 383, the IRS and Treasury are issuing these temporary amendments. The temporary amendments are substantially identical to the rules proposed on January 29, 1991.

These temporary amendments do not address the comments on the proposed amendments. Many of these comments are still under consideration.

As a companion to this Treasury decision, the IRS and Treasury are also issuing temporary regulations relating to the application of sections 382 and 383 by members of controlled groups. See TD 8679 published on page 4 in this issue of the Bulletin.

Effective Dates.

The temporary regulations are generally effective for testing dates that occur on or after January 1, 1997. Transition rules contained in the proposed amendments are retained and made applicable to testing dates before January 1, 1997.

SPECIAL ANALYSIS

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations were sent to the Small Business Administration for comment on their impact on small business.

DRAFTING INFORMATION

The principal author of the temporary regulations is David B. Friedel of the Office of Assistant Chief Counsel (Corporate), IRS. Other personnel from the IRS and Treasury participated in their development.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1502–91T also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–92T also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–93T also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–94T also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–95T also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–96T also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–98T also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–99T also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

* * *

Par. 2. Sections 1.1502–90T through 1.1502–99T are added to read as follows:

§ 1.1502–90T Table of contents (temporary). The following table contains the major headings in §§ 1.1502–91T through 1.1502–99T.

(e) Limitations of losses under other rules.

§ 1.1502–94T Coordination with section 382 and the regulations thereunder when a corporation becomes a member of a consolidated group (temporary).

(a) Scope.
(1) In general.
(2) Successor corporation as new loss member.
(3) Coordination in the case of a loss subgroup.
(4) End of separate tracking of certain losses.
(5) Cross-reference.
(b) Application of section 382 to a new loss member.
(1) In general.
(2) Adjustment to value.
(3) Pre-change separate attribute defined.
(4) Examples.
(c) Built-in gains and losses.
(d) Information statements.

§ 1.1502–95T Rules on ceasing to be a member of a consolidated group (or loss subgroup) (temporary).

(a) In general.
(1) Consolidated group.
(2) Election by common parent.
(3) Coordination with §§ 1.1502–91T through 1.1502–93T.
(b) Separate application of section 382 when a member leaves a consolidated group.
(1) In general.
(2) Effect of a prior ownership change of the group.
(3) Application in the case of a loss subgroup.
(4) Examples.
(c) Apportionment of a consolidated section 382 limitation.
(1) In general.
(2) Amount of apportionment.
(3) Effect of apportionment on the consolidated section 382 limitation.
(4) Effect on corporations to which the consolidated section 382 limitation is apportioned.
(5) Deemed apportionment when loss group terminates.
(6) Appropriate adjustments when former member leaves during the year.
(7) Examples.
(d) Rules pertaining to ceasing to be a member of a loss subgroup.
(1) In general.
(2) Examples.
(e) Filing the election to apportion.
(1) Form of the election to apportion.
(2) Signing of the election.
(3) Filing of the election.
(4) Revocation of election.

§ 1.1502–96T Miscellaneous rules (temporary).

(a) End of separate tracking of losses.
(1) Application.
(2) Effect of end of separate tracking.
(3) Continuing effect of end of separate tracking.
(4) Special rule for testing period.
(5) Limits on effects of end of separate tracking.
(b) Ownership change of subsidiary.
(1) Ownership change of a subsidiary because of options or plan or arrangement.
(2) Effect of the ownership change.
(i) In general.
(ii) Pre-change losses.
(3) Coordination with §§ 1.1502–91T, 1.1502–92T, and 1.1502–94T.
(4) Example.
(c) Continuing effect of an ownership change.

§ 1.1502–97T Special rules under section 382 for members under the jurisdiction of a court in a title 11 or similar case (temporary). [Reserved]

§ 1.1502–98T Coordination with section 383 (temporary).

§ 1.1502–99T Effective dates (temporary).

(a) Effective date.
(b) Testing period may include a period beginning before January 1, 1997.
(c) Transition rules. (1) Methods permitted. (i) In general.
(ii) Adjustments to offset excess limitation.
(iii) Coordination with effective date.
(2) Permitted methods.
(d) Amended returns.
(e) Section 383.

§ 1.1502–91T Application of section 382 with respect to a consolidated group (temporary).

(a) *Determination and effect of an ownership change*—(1) *In general.* This section and §§ 1.1502–92T and 1.1502–93T set forth the rules for determining an ownership change under section 382 for members of consolidated groups and the section 382 limitations with respect to attributes described in paragraphs (e) and (f) of this section. These rules generally provide that an ownership change and the section 382 limitation are determined with respect to these attributes for the group (or loss subgroup) on a single entity basis and not for its members separately. Following an ownership change of a loss group (or a loss subgroup) under § 1.1502–92T, the amount of consolidated taxable income for any post-change year which may be offset by pre-change consolidated attributes (or pre-change subgroup attributes) shall not exceed the consolidated section 382 limitation (or subgroup section 382 limitation) for such year as determined under § 1.1502–93T.

(2) *Special rule for post-change year that includes the change date.* If the post-change year includes the change date, section 382(b)(3)(A) is applied so that the consolidated section 382 limitation (or subgroup section 382 limitation) does not apply to the portion of consolidated taxable income that is allocable to the period in the year on or before the change date. See generally § 1.382–6 (relating to the allocation of income and loss). The allocation of consolidated taxable income for the post-change year that includes the change date must be made before taking into account any consolidated net operating loss deduction (as defined in § 1.1502–21T(a)).

(3) *Cross reference.* See §§ 1.1502–94T and 1.1502–95T for rules that apply section 382 to a corporation that becomes or ceases to be a member of a group or loss subgroup.

(b) *Definitions and nomenclature.* For purposes of this section and §§ 1.1502–92T through 1.1502–99T, unless otherwise stated:

(1) The definitions and nomenclature contained in section 382 and the regulations thereunder (including the nomenclature and assumptions relating to the examples in § 1.382–2T(b)) and this section and §§ 1.1502–92T through 1.1502–99T apply; and

(2) In all examples, all groups file consolidated returns, all corporations file their income tax returns on a calendar year basis, the only 5-percent shareholder of a corporation is a public group, the facts set forth the only owner shifts during the testing period, and each asset of a corporation has a value equal to its adjusted basis.

(c) *Loss group*—(1) *Defined.* A loss group is a consolidated group that:

(i) Is entitled to use a net operating loss carryover to the taxable year that did not arise (and is not treated under § 1.1502–21T(c) as arising) in a SRLY;

(ii) Has a consolidated net operating loss for the taxable year in which a testing date of the common parent occurs (determined by treating the common parent as a loss corporation); or

(iii) Has a net unrealized built-in loss (determined under paragraph (g) of this section by treating the date on which the determination is made as though it were a change date).

(2) *Coordination with rule that ends separate tracking.* A consolidated group may be a loss group because a member's losses that arose in (or are treated as arising in) a SRLY are treated as described in paragraph (c)(1)(i) of this section. See § 1.1502–96T(a).

(3) *Example.* The following example illustrates the principles of this paragraph (c).

Example. Loss group. (a) L and L1 file separate returns and each has a net operating loss carryover arising in Year 1 that is carried over to Year 2. A owns 40 shares and L owns 60 shares of the 100 outstanding shares of L1 stock. At the close of Year 1, L buys the 40 shares of L1 stock from A. For Year 2, L and L1 file a consolidated return. The following is a graphic illustration of these facts:

(b) L and L1 become a loss group at the beginning of Year 2 because the group is entitled to use the Year 1 net operating loss carryover of L, the common parent, which did not arise (and is not treated under § 1.1502–21T(c) as arising) in a SRLY. See § 1.1502–94T for rules relating to the application of section 382 with respect to L1's net operating loss carryover from Year 1 which did arise in a SRLY.

(d) *Loss subgroup*—(1) *Net operating loss carryovers.* Two or more corporations that become members of a consolidated group (the current group) compose a loss subgroup if:

(i) They were affiliated with each other in another group (the former group), whether or not the group was a consolidated group;

(ii) They bear the relationship described in section 1504(a)(1) to each other through a loss subgroup parent immediately after they become members of the current group; and

(iii) At least one of the members carries over a net operating loss that did not arise (and is not treated under § 1.1502–21T(c) as arising) in a SRLY with respect to the former group.

(2) *Net unrealized built-in loss.* Two or more corporations that become members of a consolidated group compose a loss subgroup if they:

(i) Have been continuously affiliated with each other for the 5 consecutive year period ending immediately before they become members of the group;

(ii) Bear the relationship described in section 1504(a)(1) to each other through a loss subgroup parent immediately after they become members of the current group; and

(iii) Have a net unrealized built-in loss (determined under paragraph (g) of this section on the day they become members of the group by treating that day as though it were a change date).

(3) *Loss subgroup parent.* A loss subgroup parent is the corporation that bears the same relationship to the other members of the loss subgroup as a common parent bears to the members of a group.

(4) *Principal purpose of avoiding a limitation.* The corporations described in paragraph (d)(1) or (2) of this section do not compose a loss subgroup if any one of them is formed, acquired, or availed of with a principal purpose of avoiding the application of, or increasing any limitation under, section 382. Instead, § 1.1502–94T applies with respect to the attributes of each such corporation. This paragraph (d)(4) does not apply solely because, in connection with becoming members of the group, the members of a group (or loss subgroup) are rearranged to bear a relationship to the other members described in section 1504(a)(1).

(5) *Special rules.* See § 1.1502–95T(d) for rules concerning when a corporation ceases to be a member of a loss subgroup. See also § 1.1502–96T(a) for a special rule regarding the end of separate tracking of SRLY losses of a member that has an ownership change or that has been a member of a group for at least 5 consecutive years.

(6) *Examples.* The following examples illustrate the principles of this paragraph (d).

Example 1. Loss subgroup. (a) P owns all the L stock and L owns all the L1 stock. The P group has a consolidated net operating loss arising in Year 1 that is carried to Year 2. On May 2, Year 2, P sells all the stock of L to A, and L and L1 thereafter file consolidated returns. A portion of the Year 1 consolidated net operating loss is apportioned under § 1.1502–21T(b) to each of L and L1, which they carry over to Year 2. The following is a graphic illustration of these facts:

(b)(1) L and L1 compose a loss subgroup within the meaning of paragraph (d)(1) of this section because—

(i) They were affiliated with each other in the P group (the former group);

(ii) They bear a relationship described in section 1504(a)(1) to each other through a loss subgroup parent (L) immediately after they became members of the L group; and

(iii) At least one of the members (here, both L and L1) carries over a net operating loss to the L group (the current group) that did not arise in a SRLY with respect to the P group.

(2) Under paragraph (d)(3) of this section, L is the loss subgroup parent of the L loss subgroup.

Example 2. Loss subgroup—section 1504(a)(1) relationship. (a) P owns all the stock of L and L1. L owns all the stock of L2. L1 and L2 own 40 percent and 60 percent of the stock of L3, respectively. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. On May 22, Year 2, P sells all the stock

of L and L1 to P1, the common parent of another consolidated group. The Year 1 consolidated net operating loss is apportioned under § 1.1502–21T(b), and each of L, L1, L2, and L3 carries over a portion of such loss to the first consolidated return year of the P1 group ending after the acquisition. The following is a graphic illustration of these facts:

(b) L and L2 compose a loss subgroup within the meaning of paragraph (d)(1) of this section. Neither L1 nor L3 is included in a loss subgroup because neither bears a relationship described in section 1504(a)(1) through a loss subgroup parent to any other member of the former group immediately after becoming members of the P1 group.

Example 3. Loss subgroup—section 1504(a)(1) relationship. The facts are the same as in *Example 2*, except that the stock of L1 is transferred to L in connection with the sale of the L stock to P1. L, L1, L2, and L3 compose a loss subgroup within the meaning of paragraph (d)(1) of this section because—

(1) They were affiliated with each other in the P group (the former group);

(2) They bear a relationship described in section 1504(a)(1) to each other through a loss subgroup parent (L) immediately after they become members of the P1 group; and

(3) At least one of the members (here, each of L, L1, L2, and L3) carries over to the P1 group (the current group) a net operating loss that did not arise in a SRLY with respect to the P group (the former group).

(e) *Pre-change consolidated attribute*—(1) *Defined.* A pre-change consolidated attribute of a loss group is—

(i) Any loss described in paragraph (c)(1)(i) or (ii) of this section (relating to the definition of loss group) that is allocable to the period ending on or before the change date; and

(ii) Any recognized built-in loss of the loss group.

(2) *Example.* The following example illustrates the principle of this paragraph (e).

Example. Pre-change consolidated attribute. (a) The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. The L loss group has an ownership change at the beginning of Year 2.

(b) The net operating loss carryover of the L loss group from Year 1 is a pre-change consolidated attribute because the L group was entitled to use the loss in Year 2, the loss did not arise in a SRLY with respect to the L group, and therefore the loss was described in paragraph (c)(1)(i) of this section. Under paragraph (a) of this section, the amount of consolidated taxable income of the L group for Year 2 that may be offset by this loss carryover may not exceed the consolidated section 382 limitation of the L group for that year. See § 1.1502–93T for rules relating to the computation of the consolidated section 382 limitation.

(f) *Pre-change subgroup attribute*—(1) *Defined.* A pre-change subgroup attribute of a loss subgroup is—

(i) Any net operating loss carryover described in paragraph (d)(1)(iii) of this section (relating to the definition of loss subgroup); and

(ii) Any recognized built-in loss of the loss subgroup.

(2) E*xample.* The following example illustrates the principle of this paragraph (f).

Example. Pre-change subgroup attribute. (a) P is the common parent of a consolidated group. P owns all the stock of L, and L owns all the stock of L1. L2 is not a member of an affiliated group, and has a net operating loss arising in Year 1 that is carried over to Year 2. On December 11, Year 2, L1 acquires all the stock of L2, causing an ownership change of L2. During Year 2, the P group has a consolidated net operating loss that is carried over to Year 3. On November 2, Year 3, M acquires all the L stock from P. M, L, L1, and L2 thereafter file consolidated returns. All of the P group Year 2 consolidated net operating loss is apportioned under § 1.1502–21T(b) to L and L2, which they carry over to the M group.

(b)(1) L, L1, and L2 compose a loss subgroup because—

(i) They were affiliated with each other in the P group (the former group);

(ii) They bore a relationship described in section 1504(a)(1) to each other through a loss subgroup parent (L) immediately after they became members of the L group; and

(iii) At least one of the members (here, both L and L2) carries over a net operating loss to the M group (the current group) that is described in paragraph (d)(1)(iii) of this section.

(2) For this purpose, L2's loss from Year 1 that was a SRLY loss with respect to the P group (the former group) is treated as described in paragraph (d)(1)(iii) of this section because of the application of the principles of § 1.1502–96T(a). See paragraph (d)(5) of this section. M's acquisition results in an ownership change of L, and therefore the L loss subgroup under § 1.1502–92T(a)(2). See § 1.1502–93T for rules governing the computation of the subgroup section 382 limitation.

(c) In the M group, L2's Year 1 loss continues to be subject to a section 382 limitation resulting from the ownership change that occurred on December 11, Year 2. See § 1.1502–96T(c).

(g) *Net unrealized built-in gain and loss*—(1) *In general.* The determination whether a consolidated group (or loss subgroup) has a net unrealized built-in gain or loss under section 382(h)(3) is based on the aggregate amount of the separately computed net unrealized built-in gains or losses of each member that is included in the group (or loss subgroup) under paragraph (g)(2) of this section, including items of built-in income and deduction described in section 382(h)(6). Thus, for example, amounts deferred under section 267, or under § 1.1502–13 (other than amounts deferred with respect to the stock of a member (or an intercompany obligation) included in the group (or loss subgroup) under paragraph (g)(2) of this section) are built-in items. The threshold requirement under section 382(h)(3)(B) applies on an aggregate basis and not on a member-by-member basis. The separately computed amount of a member included in a group or loss subgroup does not include any unrealized built-in gain or loss on stock (including stock described in section 1504(a)(4) and § 1.382–2T(f)(18)(ii) and (iii)) of another member included in the group or loss subgroup (or on an intercompany obligation). However, a member of a group or loss subgroup includes in its separately computed amount the unrealized built-in gain or loss on stock of another member (or on an intercompany obligation) not included in the group or loss subgroup. If a member is not included in a group (or loss subgroup) under paragraph (g)(2) of this section, the determination of whether the member has a net unrealized built-in gain or loss under section 382(h)(3) is made on a separate entity basis. See § 1.1502–94(c) (relating to built-in gain or loss of a new loss member) and § 1.1502–96(a) (relating to the end of separate tracking of certain losses).

(2) *Members included*—(i) *Consolidated group.* The members included in the determination whether a consolidated group has a net unrealized built-in gain or loss are all members of the group on the day that the determination is made other than—

(A) A new loss member with a net unrealized built-in loss described in § 1.1502–94T(a)(1)(ii); and

(B) Members included in a loss subgroup described in § 1.1502–91T(d)(2).

(ii) *Loss subgroup.* The members included in the determination whether a

loss subgroup has a net unrealized built-in gain or loss are those members described in paragraphs (d)(2)(i) and (ii) of this section.

(3) *Acquisitions of built-in gain or loss assets.* A member of a consolidated group (or loss subgroup) may not, in determining its separately computed net unrealized built-in gain or loss, include any gain or loss with respect to assets acquired with a principal purpose to affect the amount of its net unrealized built-in gain or loss. A group (or loss subgroup) may not, in determining its net unrealized built-in gain or loss, include any gain or loss of a member acquired with a principal purpose to affect the amount of its net unrealized built-in gain or loss.

(4) *Indirect ownership.* A member's separately computed net unrealized built-in gain or loss is adjusted to the extent necessary to prevent any duplication of unrealized gain or loss attributable to the member's indirect ownership interest in another member through a nonmember if the member has a 5-percent or greater ownership interest in the nonmember.

(h) *Recognized built-in gain or loss*—(1) *In general.* [Reserved]

(2) *Disposition of stock or an intercompany obligation of a member.* Gain or loss recognized by a member on the disposition of stock (including stock described in section 1504(a)(4) and § 1.382–2T(f)(18)(ii) and (iii)) of another member or an intercompany obligation is treated as a recognized built-in gain or loss under section 382(h)(2) (unless disallowed under § 1.1502–20 or otherwise), even though gain or loss on such stock or obligation was not included in the determination of a net unrealized built-in gain or loss under paragraph (g)(1) of this section.

(3) *Deferred gain or loss.* Gain or loss that is deferred under provisions such as section 267 and § 1.1502–13 is treated as recognized built-in gain or loss only to the extent taken into account by the group during the recognition period.

(4) *Exchanged basis property.* If the adjusted basis of any asset is determined, directly or indirectly, in whole or in part, by reference to the adjusted basis of another asset held by the member at the beginning of the recognition period, the asset is treated, with appropriate adjustments, as held by the member at the beginning of the recognition period.

(i) [Reserved]

(j) *Predecessor and successor corporations.* A reference in this section and §§ 1.1502–92T through 1.1502–99T to a corporation, member, common parent, loss subgroup parent, or subsidiary includes, as the context may require, a reference to a predecessor or successor corporation. For example, the determination whether a successor satisfies the continuous affiliation requirement of paragraph (d)(2)(i) of this section is made by reference to its predecessor.

§ 1.1502–92T Ownership change of a loss group or a loss subgroup (temporary).

(a) *Scope.* This section provides rules for determining if there is an ownership change for purposes of section 382 with respect to a loss group or a loss subgroup. See § 1.1502–94T for special rules for determining if there is an ownership change with respect to a new loss member and § 1.1502–96T(b) for special rules for determining if there is an ownership change of a subsidiary.

(b) *Determination of an ownership change*—(1) *Parent change method*—(i) *Loss group.* A loss group has an ownership change if the loss group's common parent has an ownership change under section 382 and the regulations thereunder. Solely for purposes of determining whether the common parent has an ownership change—

(A) The losses described in § 1.1502–91T(c) are treated as net operating losses (or a net unrealized built-in loss) of the common parent; and

(B) The common parent determines the earliest day that its testing period can begin by reference to only the attributes that make the group a loss group under § 1.1502–91T(c).

(ii) *Loss subgroup.* A loss subgroup has an ownership change if the loss subgroup parent has an ownership change under section 382 and the regulations thereunder. The principles of § 1.1502–95T(b) (relating to ceasing to be a member of a consolidated group) apply in determining whether the loss subgroup parent has an ownership change. Solely for purposes of determining whether the loss subgroup parent has an ownership change—

(A) The losses described in § 1.1502–91T(d) are treated as net operating losses (or a net unrealized built-in loss) of the loss subgroup parent;

(B) The day that the members of the loss subgroup become members of the group (or a loss subgroup) is treated as a testing date within the meaning of § 1.382–2(a)(4); and

(C) The loss subgroup parent determines the earliest day that its testing period can begin under § 1.382–2T(d)(3) by reference to only the attributes that make the members a loss subgroup under § 1.1502–91T(d).

(2) *Examples.* The following examples illustrate the principles of this paragraph (b).

Example 1. Loss group—ownership change of the common parent. (a) A owns all the L stock. L owns 80 percent and B owns 20 percent of the L1 stock. For Year 1, the L group has a consolidated net operating loss that resulted from the operations of L1 and that is carried over to Year 2. The value of the L stock is $1000. The total value of the L1 stock is $600 and the value of the L1 stock held by B is $120. The L group is a loss group under § 1.1502–91T(c)(1) because it is entitled to use its net operating loss carryover from Year 1. On August 15, Year 2, A sells 51 percent of the L stock to C. The following is a graphic illustration of these facts:

(b) Under paragraph (b)(1)(i) of this section, section 382 and the regulations thereunder are applied to L to determine whether it (and therefore the L loss group) has an ownership change with respect to its net operating loss carryover from Year 1 attributable to L1 on August 15, Year 2. The sale of the L stock to C causes an ownership change of L under § 1.382–2T and of the L loss group under paragraph (b)(1)(i) of this section. The amount of consolidated taxable income of the L loss group for any post-change taxable year that may be offset by its pre-change consolidated attributes (that is, the net operating loss carryover from Year 1 attributable to L1) may not exceed the consolidated section 382 limitation for the L loss group for the taxable year.

Example 2. Loss group—owner shifts of subsidiaries disregarded. (a) The facts are the same as in *Example 1*, except that on August 15, Year 2, A sells only 49 percent of the L stock to C and, on December 12, Year 3, in an unrelated transaction, B sells the 20 percent of the L1 stock to D. A's sale of the L stock to C does not cause an ownership change of L under § 1.382–2T nor of the L loss group under paragraph (b)(1)(i) of this section. The following is a graphic illustration of these facts:

(b) B's subsequent sale of L1 stock is not taken into account for purposes of determining whether the L loss group has an ownership change under paragraph (b)(1)(i) of this section, and, accordingly, there is no ownership change of the L loss group. See paragraph (c) of this section, however, for a supplemental ownership change method that would apply to cause an ownership change if the purchases by C and D were pursuant to a plan or arrangement.

Example 3. Loss subgroup—ownership change of loss subgroup parent controls. (a) P owns all the L stock. L owns 80 percent and A owns 20 percent of the L1 stock. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. On September 9, Year 2, P sells 51 percent of the L stock to B, and L1 is apportioned a portion of the Year 1 consolidated net operating loss under § 1.1502–21T(b), which it carries over to its next taxable year. L and L1 file a consolidated return for their first taxable year ending after the sale to B. The following is a graphic illustration of these facts:

(b) Under § 1.1502–91T(d)(1), L and L1 compose a loss subgroup on September 9, Year 2, the day that they become members of the L group. Under paragraph (b)(1)(ii) of this section, section 382 and the regulations thereunder are applied to L to determine whether it (and therefore the L loss subgroup) has an ownership change with respect to the portion of the Year 1 consolidated net operating loss that is apportioned to L1 on September 9, Year 2. L has an ownership change resulting from P's sale of 51 percent of the L stock to A. Therefore, the L loss subgroup has an ownership change with respect to that loss.

Example 4. Loss group and loss subgroup—contemporaneous ownership changes. (a) A owns all the stock of corporation M, M owns 35 percent and B owns 65 percent of the L stock, and L owns all the L1 stock. The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. On May 19, Year 2, B sells 45 percent of the L stock to M for cash. M, L, and L1 thereafter file consolidated returns. L and L1 are each apportioned a portion of the Year 1 consolidated net operating loss, which they carry over to the M group's Year 2 and Year 3 consolidated return years. The M group has a consolidated net operating loss arising in Year 2 that is carried over to Year 3. On June 9, Year 3, A sells 70 percent of the M stock to C. The following is a graphic illustration of these facts:

(b) Under § 1.1502–91T(d)(1), L and L1 compose a loss subgroup on May 19, Year 2, the day they become members of the M group. Under paragraph (b)(1)(ii) of this section, section 382 and the regulations thereunder are applied to L to determine whether L (and therefore the L loss subgroup) has an ownership change with respect to the loss carryovers from Year 1 on May 19, Year 2, a testing date because of B's sale of L stock to M. The sale of L stock to M results in only a 45 percentage point increase in A's ownership of L stock. Thus, there is no ownership change of L (or the L loss subgroup) with respect to those loss carryovers under paragraph (b)(1)(ii) of this section on that day.

(c) June 9, Year 3, is also a testing date with respect to the L loss subgroup because of A's sale of M stock to C. The sale results in a 56 percentage point increase in C's ownership of L stock, and L has an ownership change. Therefore, the L loss subgroup has an ownership change on that day with respect to the loss carryovers from Year 1.

(d) Paragraph (b)(1)(i) of this section requires that section 382 and the regulations thereunder be applied to M to determine whether M (and therefore the M loss group) has an ownership change with respect to the net operating loss carryover from Year 2 on June 9, Year 3, a testing date because of A's sale of M stock to C. The sale results in a 70 percentage point increase in C's ownership of M stock, and M has an ownership change. Therefore, the M loss group has an ownership change on that day with respect to that loss carryover.

(3) *Special adjustments*—(i) *Common parent succeeded by a new common parent.* For purposes of determining if a loss group has an ownership change, if the common parent of a loss group is succeeded or acquired by a new common parent and the loss group remains in existence, the new common parent is treated as a continuation of the former common parent with appropriate adjustments to take into account shifts in ownership of the former common parent during the testing period (including shifts that occur incident to the common parent's becoming the former common parent).

(ii) *Newly created loss subgroup parent.* For purposes of determining if a loss subgroup has an ownership change, if the member that is the loss subgroup parent has not been the loss subgroup parent for at least 3 years as of a testing date, appropriate adjustments must be made to take into account owner shifts of members of the loss subgroup so that the structure of the loss subgroup does not have the effect of avoiding an ownership change under section 382. (See paragraph (b)(3)(iii) *Example 3* of this section.)

(iii) *Examples.* The following examples illustrate the principles of this paragraph (b)(3).

Example 1. New common parent acquires old common parent. (a) A, who owns all the L stock,

sells 30 percent of the L stock to B on August 26, Year 1. L owns all the L1 stock. The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 3. On July 16, Year 2, A and B transfer their L stock to a newly created holding company, HC, in exchange for 70 percent and 30 percent, respectively, of the HC stock. HC, L, and L1 thereafter file consolidated returns. Under the principles of § 1.1502–75(d), the L loss group is treated as remaining in existence, with HC taking the place of L as the new common parent of the loss group. The following is a graphic illustration of these facts:

(b) On November 11, Year 3, A sells 25 percent of the HC stock to B. For purposes of determining if the L loss group has an ownership change under paragraph (b)(1)(i) of this section on November 11, Year 3, HC is treated as a continuation of L under paragraph (b)(3)(i) of this section because it acquired L and became the common parent without terminating the L loss group. Accordingly, HC's testing period commences on January 1, Year 1, the first day of the taxable year of the L loss group in which the consolidated net operating loss that is carried over to Year 3 arose (see § 1.382–2T(d)(3)(i)). Immediately after the close of November 11, Year 3, B's percentage ownership interest in the common parent of the loss group (HC) has increased by 55 percentage points over its lowest percentage ownership during the testing period (zero percent). Accordingly, HC and the L loss group have an ownership change on that day.

Example 2. New common parent in case in which common parent ceases to exist. (a) A, B, and C each own one-third of the L stock. L owns all the L1 stock. The L group has a consolidated net operating loss arising in Year 2 that is carried over to Year 3. On November 22, Year 3, L is merged into P, a corporation owned by D, and L1 thereafter files consolidated returns with P. A, B, and C, as a result of owning stock of L, own 90 percent of P's stock after the merger. D owns the remaining 10 percent of P's stock. The merger of L into P qualifies as a reverse acquisition of the L group under § 1.1502–75(d)(3)(i), and the L loss group is treated as remaining in existence, with P taking the place of L as the new common parent of the L group. The following is a graphic illustration of these facts:

(b) For purposes of determining if the L loss group has an ownership change on November 22, Year 3, the day of the merger, P is treated as a continuation of L so that the testing period for P begins on January 1, Year 2, the first day of the taxable year of the L loss group in which the consolidated net operating loss that is carried over to Year 3 arose. Immediately after the close of November 22, Year 3, D is the only 5-percent shareholder that has increased his ownership interest in P during the testing period (from zero to 10 percentage points).

(c) The facts are the same as in paragraph (a) of this *Example 2*, except that A has held 23⅓ shares (23⅓ percent) of L's stock for five years, and A purchased an additional 10 shares of L stock from E two years before the merger. Immediately after the close of the day of the merger (a testing date), A's ownership interest in P, the common parent of the L loss group, has increased by 6⅔ percentage points over her lowest percentage ownership during the testing period (23⅓ percent to 30 percent).

(d) The facts are the same as in (a) of this *Example 2*, except that P has a net operating loss arising in Year 1 that is carried to the first consolidated return year ending after the day of the merger. Solely for purposes of determining whether the L loss group has an ownership change under paragraph (b)(1)(i) of this section, the testing period for P commences on January 1, Year 2. P does not determine the earliest day for its testing period by reference to its net operating loss carryover from Year 1, which §§ 1502–1(f)(3) and 1.1502–75(d)(3)(i) treat as arising in a SRLY. See § 1.1502–94T to determine the application of section 382 with respect to P's net operating loss carryover.

Example 3. Newly acquired loss subgroup parent. (a) P owns all the L stock and L owns all the L1 stock. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 3. On January 19, Year 2, L issues a 20 percent stock interest to B. On February 5, Year 3, P contributes its L stock to a newly formed subsidiary, HC, in exchange for all the HC stock, and distributes the HC stock to its sole shareholder A. HC, L, and L1 thereafter file consolidated returns. A portion of the P group's Year 1 consolidated net operating loss is apportioned to L and L1 under § 1.1502–21T(b) and is carried over to the HC group's year ending after February 5, Year 3. HC, L, and L1 compose a loss subgroup within the meaning of § 1.1502–91T(d) with respect to the net operating loss carryovers from Year 1. The following is a graphic illustration of these facts:

(b) February 5, Year 3, is a testing date for HC as the loss subgroup parent with respect to the net operating loss carryovers of L and L1 from Year 1. See paragraph (b)(1)(ii)(B) of this section. For purposes of determining whether HC has an ownership change on the testing date, appropriate adjustments must be made with respect to the changes in the percentage ownership of the stock of HC because HC was not the loss subgroup parent for at least 3 years prior to the day on which it became a member of the HC loss subgroup (a testing date). The appropriate adjustments include adjustments so that HC succeeds to the owner shifts of other members of the former group. Thus, HC succeeds to the owner shift of L that resulted from the sale of the 20 percent interest to B in determining whether the HC loss subgroup has an ownership change on February 5, Year 3, and on any subsequent testing date that includes January 19, Year 2.

(4) E*nd of separate tracking of certain losses.* If § 1.1502–96T(a) (relating to the end of separate tracking of attributes) applies to a loss subgroup, then, while one or more members that were included in the loss subgroup remain members of the consolidated group, there is an ownership change with respect to their attributes described in § 1.1502–96T(a)(2) only if the consolidated group is a loss group and has an ownership change under paragraph (b)(1)(i) of this section (or such a member has an ownership change under § 1.1502–96T(b) (relating to ownership changes of subsidiaries)). If, however, the loss subgroup has had an ownership change before § 1.1502–96T(a) applies, see § 1.1502–96T(c) for the continuing application of the subgroup's section 382 limitation with respect to its pre-change subgroup attributes.

(c) *Supplemental rules for determining ownership change*—(1) *Scope.* This paragraph (c) contains a supplemental rule for determining whether there is an ownership change of a loss group (or loss subgroup). It applies in addition to, and not instead of, the rules of paragraph (b) of this section. Thus, for example, if the common parent of the loss group has an ownership change under paragraph (b) of this section, the loss group has an ownership change even if, by applying this paragraph (c), the common parent would not have an ownership change.

(2) *Cause for applying supplemental rule.* This paragraph (c) applies to a loss group (or loss subgroup) if—

(i) Any 5-percent shareholder of the common parent (or loss subgroup parent) increases its percentage ownership interest in the stock of both—

(A) A subsidiary of the loss group (or loss subgroup) other than by a direct or indirect acquisition of stock of the common parent (or loss subgroup parent); and

(B) The common parent (or loss subgroup parent); and

(ii) Those increases occur within a 3 year period ending on any day of a consolidated return year or, if shorter, the period beginning on the first day following the most recent ownership change of the loss group (or loss subgroup).

(3) *Operating rules.* Solely for purposes of this paragraph (c)—

(i) A 5-percent shareholder of the common parent (or loss subgroup parent) is treated as increasing its percentage ownership interest in the common parent (or loss subgroup parent) or a subsidiary to the extent, if any, that any person acting pursuant to a plan or arrangement with the 5-percent shareholder increases its percentage ownership interest in the stock of that entity;

(ii) The rules in section 382(l)(3) and §§ 1.382–2T(h) and 1.382–4(d) (relating to constructive ownership) apply with respect to the stock of the subsidiary by treating such stock as stock of a loss corporation; and

(iii) In the case of a loss subgroup, a subsidiary includes any member of the loss subgroup other than the loss subgroup parent. (The loss subgroup parent is, however, a subsidiary of the loss group of which it is a member.)

(4) *Supplemental ownership change rules.* The determination whether the common parent (or loss subgroup parent) has an ownership change is made by applying paragraph (b)(1) of this section as modified by the following additional rules—

(i) *Additional testing dates for the common parent (or loss subgroup parent).* A testing date for the common parent (or loss subgroup parent) also includes—

(A) Each day on which there is an increase in the percentage ownership of stock of a subsidiary as described in paragraph (c)(2) of this section; and

(B) The first day of the first consolidated return year for which the group is a loss group (or the members compose a loss subgroup);

(ii) *Treatment of subsidiary stock as stock of the common parent (or loss subgroup parent).* The common parent (or loss subgroup parent) is treated as though it had issued to the person acquiring (or deemed to acquire) the subsidiary stock an amount of its own stock (by value) that equals the value of the subsidiary stock represented by the percentage increase in that person's ownership of the subsidiary (determined on a separate entity basis). A similar principle applies if the increase in percentage ownership interest is effected by a redemption or similar transaction; and

(iii) *5-percent shareholder of the common parent (or loss subgroup parent).* Any person described in paragraph (c)(3)(i) of this section who is acting pursuant to the plan or arrangement is treated as a 5-percent shareholder of the common parent (or loss subgroup parent).

(5) *Examples.* The following examples illustrate the principles of this paragraph (c).

Example 1. Stock of the common parent under supplemental rules. (a) A owns all the L stock. L is not a member of an affiliated group and has a net operating loss carryover arising in Year 1 that is carried over to Year 6. On September 20, Year 6, L transfers all of its assets and liabilities to a newly created subsidiary, S, in exchange for S stock. L and S thereafter file consolidated returns. On November 23, Year 6, B contributes cash to L in exchange for a 45 percent ownership interest in L and contributes cash to S for a 20 percent ownership interest in S.

(b) B is a 5-percent shareholder of L who increases his percentage ownership interest in L and S during the 3 year period ending on November 23, Year 6. Under paragraph (c)(4)(ii) of this section, the determination whether L (the common parent of a loss group) has an ownership change on November 23, Year 6 (or on any testing date in the testing period which includes November 23, Year 6), is made by applying paragraph (b)(1)(i) of this section and by treating the value of B's 20 percent ownership interest in S as if it were L stock issued to B.

Example 2. Plan or arrangement—public offering of subsidiary stock. (a) A owns all the stock of L and L owns all the stock of L1. The L group has a consolidated net operating loss arising in Year 1 that resulted from the operations of L1 and that is carried over to Year 2. As part of a plan, A sells 49 percent of the L stock to B on October 7, Year 2, and L1 issues new stock representing a 20 percent ownership interest in L1 to the public on November 6, Year 2. The following is a graphic illustration of these facts:

(b) A's sale of the L stock to B does not cause an ownership change of the L loss group on October 7, Year 2, under the rules of § 1.382–2T and paragraph (b)(1)(i) of this section.

(c) Because the issuance of L1 stock to the public occurs in connection with B's acquisition of L stock pursuant to a plan, paragraph (c)(4) of this section applies to determine whether the L loss group has an ownership change on November 6, Year 2 (or on any testing date for which the testing period includes November 6, Year 2).

(d) *Testing period following ownership change under this section.* If a loss group (or a loss subgroup) has had an ownership change under this section, the testing period for determining a subsequent ownership change with respect to pre-change consolidated attributes (or pre-change subgroup attributes) begins no earlier than the first day following the loss group's (or loss subgroup's) most recent change date.

(e) *Information statements*—(1) *Common parent of a loss group.* The common parent of a loss group must file the information statement required by § 1.382–2T(a)(2)(ii) for a consolidated return year because of any owner shift, equity structure shift, or the issuance or transfer of an option—

(i) With respect to the common parent and with respect to any subsidiary stock subject to paragraph (c) of this section; and

(ii) With respect to an ownership change described in § 1.1502–96T(b) (relating to ownership changes of subsidiaries).

(2) *Abbreviated statement with respect to loss subgroups.* The common parent of a consolidated group that has a loss subgroup during a consolidated return year must file the information statement required by § 1.382–2T(a)(2)(ii) because of any owner shift, equity structure shift, or issuance or transfer of an option with respect to the loss subgroup parent and with respect to any subsidiary stock subject to paragraph (c) of this section. Instead of filing a separate statement for each loss subgroup parent, the common parent (which is treated as a loss corporation) may file the single statement described in paragraph (e)(1) of this section. In addition to the information concerning stock ownership of the common parent, the single statement must identify each loss subgroup parent and state which loss subgroups, if any, have had ownership changes during the consolidated return year. The loss subgroup parent is, however, still required to maintain the records necessary to determine if the loss subgroup has an ownership change. This paragraph (e)(2) applies with respect to the attributes of a loss subgroup until, under § 1.1502–96T(a), the attributes are no longer treated as described in § 1.1502–91T(d) (relating to the definition of loss subgroup). After that time, the information statement described in paragraph (e)(1) of this section must be filed with respect to those attributes.

§ 1.1502–93T Consolidated section 382 limitation (or subgroup section 382 limitation) (temporary).

(a) *Determination of the consolidated section 382 limitation (or subgroup section 382 limitation)*—(1) *In general.* Following an ownership change, the consolidated section 382 limitation (or subgroup section 382 limitation) for any post-change year is an amount equal to the value of the loss group (or loss subgroup), as defined in paragraph (b) of this section, multiplied by the long-term tax-exempt rate that applies with respect to the ownership change, and adjusted as required by section 382 and the regulations thereunder. See, for example, section 382(b)(2) (relating to the carryforward of unused section 382 limitation), section 382(b)(3)(B) (relating to the section 382 limitation for the post-change year that includes the change date), section 382(m)(2) (relating to short taxable years), and section 382(h) (relating to recognized built-in gains and section 338 gains).

(2) *Coordination with apportionment rule.* For special rules relating to apportionment of a consolidated section 382 limitation (or a subgroup section 382 limitation) when one or more corporations cease to be members of a loss group (or a loss subgroup) and to aggregation of amounts so apportioned, see § 1.1502–95T(c).

(b) *Value of the loss group (or loss subgroup)*—(1) *Stock value immediately before ownership change.* Subject to any adjustment under paragraph (b)(2) of this section, the value of the loss group (or loss subgroup) is the value, immediately before the ownership change, of the stock of each member, other than stock that is owned directly or indirectly by another member. For this purpose—

(i) Ownership is determined under § 1.382–2T;

(ii) A member is considered to indirectly own stock of another member through a nonmember only if the member has a 5-percent or greater ownership interest in the nonmember; and

(iii) Stock includes stock described in section 1504(a)(4) and § 1.382–2T(f)(18)(ii) and (iii).

(2) *Adjustment to value.* The value of the loss group (or loss subgroup), as determined under paragraph (b)(1) of this section, is adjusted under any rule in section 382 or the regulations thereunder requiring an adjustment to such value for purposes of computing the amount of the section 382 limitation. See, for example, section 382(e)(2) (redemptions and corporate contractions), section 382(l)(1) (certain capital contributions) and section 382(l)(4) (ownership of substantial nonbusiness assets). The value of the loss group (or loss subgroup) determined under this paragraph (b) is also adjusted to the extent necessary to prevent any duplication of the value of the stock of a member. For example, the principles of § 1.382–8T (relating to controlled groups of corporations) apply in determining the value of a loss group (or loss subgroup) if, under § 1.1502–91T(g)(2), members are not included in the determination whether the group (or loss subgroup) has a net unrealized built-in loss.

(3) E*xamples.* The following examples illustrate the principles of this paragraph (b).

Example 1. Basic case. (a) L, L1, and L2 compose a loss group. L has outstanding common stock, the value of which is $100. L1 has outstanding common stock and preferred stock that is described in section 1504(a)(4). L owns 90 percent of the L1 common stock, and A owns the remaining 10 percent of the L1 common stock plus all the preferred stock. The value of the L1 common stock is $40, and the value of the L1 preferred stock is $30. L2 has outstanding common stock, 50 percent of which is owned by L and 50 percent by L1. The L group has an ownership change. The following is a graphic illustration of these facts:

(b) Under paragraph (b)(1) of this section, the L group does not include the value of the stock of any member that is owned directly or indirectly by another member in computing its consolidated section 382 limitation. Accordingly, the value of the stock of the loss group is $134, the sum of the value of—

(1) The common stock of L ($100);

(2) the 10 percent of the L1 common stock ($4) owned by A; and

(3) The L1 preferred stock ($30) owned by A.

Example 2. Indirect ownership. (a) L and L1 compose a consolidated group. L's stock has a value of $100. L owns 80 shares (worth $80) and corporation M owns 20 shares (worth $20) of the L1 stock. L also owns 79 percent of the stock of corporation M. The L group has an ownership change. The following is a graphic illustration of these facts:

(b) Under paragraph (b)(1) of this section, because of L's more than 5 percent ownership interest in M, a nonmember, L is considered to indirectly own 15.8 shares of the L1 stock held by M (79% x 20 shares). The value of the L loss group is $104.20, the sum of the values of—

(1) The L stock ($100); and

(2) The L1 stock not owned directly or indirectly by L (21% x $20, or $4.20).

(c) *Recognized built-in gain of a loss group or loss subgroup.* If a loss group (or loss subgroup) has a net unrealized built-in gain, any recognized built-in gain of the loss group (or loss subgroup) is taken into account under section 382(h) in determining the consolidated section 382 limitation (or subgroup section 382 limitation).

(d) *Continuity of business*—(1) *In general.* A loss group (or a loss subgroup) is treated as a single entity for purposes of determining whether it satisfies the continuity of business enterprise requirement of section 382(c)(1).

(2) *Example.* The following example illustrates the principle of this paragraph (d).

Example. Continuity of business enterprise. L owns all the stock of two subsidiaries, L1 and L2. The L group has an ownership change. It has pre-change consolidated attributes attributable to L2. Each of the members has historically conducted a separate line of business. Each line of business is approximately equal in value. One year after the ownership change, L discontinues its separate business and the business of L2. The separate business of L1 is continued for the remainder of the 2 year period following the ownership change. The continuity of business enterprise requirement of section 382(c)(1) is met even though the separate businesses of L and L2 are discontinued.

(e) *Limitations of losses under other rules.* If a section 382 limitation for a post-change year exceeds the consolidated taxable income that may be offset by pre-change attributes for any reason, including the application of the limitation of § 1.1502–21T(c), the amount of the excess is carried forward under section 382(b)(2) (relating to the carryforward of unused section 382 limitation).

§ 1.1502–94T Coordination with section 382 and the regulations thereunder when a corporation becomes a member of a consolidated group (temporary).

(a) *Scope*—(1) *In general.* This section applies section 382 and the regulations thereunder to a corporation that is a new loss member of a consolidated group. A corporation is a new loss member if it—

(i) Carries over a net operating loss that arose (or is treated under § 1.1502–21T(c) as arising) in a SRLY with respect to the current group, and that is not described in § 1.1502–91T(d)(1); or

(ii) Has a net unrealized built-in loss (determined under paragraph (c) of this section on the day it becomes a member of the current group by treating that day as a change date) that is not taken into account under § 1.1502–91T(d)(2) in determining whether two or more corporations compose a loss subgroup.

(2) *Successor corporation as new loss member.* A new loss member also includes any successor to a corporation that has a net operating loss carryover arising in a SRLY and that is treated as remaining in existence under § 1.382–2(a)(1)(ii) following a transaction described in section 381(a).

(3) *Coordination in the case of a loss subgroup.* For rules regarding the determination of whether there is an ownership change of a loss subgroup with respect to a net operating loss or a net unrealized built-in loss described in § 1.1502–91T(d) (relating to the definition of loss subgroup) and the computation of a subgroup section 382 limitation following such an ownership change, see §§ 1.1502–92T and 1.1502–93T.

(4) *End of separate tracking of certain losses.* If § 1.1502–96T(a) (relating to the end of separate tracking of attributes) applies to a new loss member, then, while that member remains a member of the consolidated group, there is an ownership change with respect to its attributes described in § 1.1502–96T(a)(2) only if the consolidated group is a loss group and has an ownership change under § 1.1502–92T(b)(1)(i) (or that member has an ownership change under § 1.1502–96T(b) (relating to ownership changes of subsidiaries)). If, however, the new loss member has had an ownership change before § 1.1502–96T(a) applies, see § 1.1502–96T(c) for the continuing application of the section 382 limitation with respect to the member's pre-change losses.

(5) *Cross-reference.* See section 382(a) and § 1.1502–96T(c) for the continuing effect of an ownership change after a corporation becomes or ceases to be a member.

(b) *Application of section 382 to a new loss member*—(1) *In general.* Section 382 and the regulations thereunder apply to a new loss member to determine, on a separate entity basis, whether and to what extent a section 382 limitation applies to limit the amount of consolidated taxable income that may be offset by the new loss member's pre-change separate attributes. For example, if an ownership change with respect to the new loss member occurs under section 382 and the regulations thereunder, the amount of consolidated taxable income for any post-change year that may be offset by the new loss member's pre-change separate attributes shall not exceed the section 382 limitation as determined separately under section 382(b) with respect to that member for such year. If the post-change year includes the change date, section 382(b)(3)(A) is applied so that the section 382 limitation of the new loss member does not apply to the portion of the taxable income for such year that is allocable to the period in such year on or before the change date. See generally § 1.382–6 (relating to the allocation of income and loss).

(2) *Adjustment to value.* The value of the new loss member is adjusted to the extent necessary to prevent any duplication of the value of the stock of a member. For example, the principles of § 1.382–8T (relating to controlled groups of corporations) apply in determining the value of a new loss member.

(3) *Pre-change separate attribute defined.* A pre-change separate attribute of a new loss member is—

(i) Any net operating loss carryover of the new loss member described in paragraph (a)(1) of this section; and

(ii) Any recognized built-in loss of the new loss member.

(4) *Examples.* The following examples illustrate the principles of this paragraph (b).

Example 1. Basic case. (a) A and P each own 50 percent of the L stock. On December 19, Year 6, P purchases 30 percent of the L stock from A for cash. L has net operating losses arising in Year 1 and Year 2 that it carries over to Year 6 and Year 7. The following is a graphic illustration of these facts:

(b) L is a new loss member because it has net operating loss carryovers that arose in a SRLY with respect to the P group and L is not a member of a loss subgroup under § 1.1502–91T(d). Under section 382 and the regulations thereunder, L is a loss corporation on December 19, Year 6, that day is a testing date for L, and the testing period for L commences on December 20, Year 3.

(c) P's purchase of L stock does not cause an ownership change of L on December 19, Year 6, with respect to the net operating loss carryovers from Year 1 and Year 2 under section 382 and § 1.382–2T. The use of the loss carryovers, however, is subject to limitation under § 1.1502–21T(c).

Example 2. Multiple new loss members. (a) The facts are the same as in *Example 1*, and, on December 31, Year 6, L purchases all the stock of L1 from B for cash. L1 has a net operating loss of $40 arising in Year 3 that it carries over to Year 7. The following is a graphic illustration of these facts:

(b) L1 is a new loss member because it has a net operating loss carryover from Year 3 that arose in a SRLY with respect to the P group and L1 is not a member of a loss subgroup under § 1.1502–91T(d)(1).

(c) L's purchase of all the stock of L1 causes an ownership change of L1 on December 31, Year 6, under section 382 and § 1.382–2T. Accordingly, a section 382 limitation based on the value of the L1 stock immediately before the ownership change limits the amount of consolidated taxable income of the P group for any post-change year that may be offset by L1's loss from Year 3.

(d) L1's ownership change in connection with its becoming a member of the P group is an ownership change described in § 1.1502–96T(a). Thus, starting on January 1, Year 7, the P group no longer separately tracks owner shifts of the stock of L1 with respect to L1's loss from Year 3. Instead, the P group is a loss group because of such loss under § 1.1502–91T(c).

Example 3. Ownership changes of new loss members. (a) The facts are the same as in Example 2, and, on April 30, Year 7, C purchases all the stock of P for cash.

(b) L is a new loss member on April 30, Year 7, because its Year 1 and Year 2 losses arose in SRLYs with respect to the P group and it is not a member of a loss subgroup under § 1.1502–91T(d)(1). The testing period for L commences on May 1, Year 4. C's purchase of all the P stock causes an ownership change of L on April 30, Year 7, under section 382 and § 1.382–2T with respect to its Year 1 and Year 2 losses. Accordingly, a section 382 limitation based on the value of the L stock immediately before the ownership change limits the amount of consolidated taxable income of the P group for any post-change year that may be offset by L's Year 1 and Year 2 losses. The use of those carryovers is also subject to limitation under § 1.1502–21T(c).

(c) The P group is a loss group on April 30, Year 7, because it is entitled to use L1's loss from Year 3, and such loss is no longer treated as a loss of a new loss member starting the day after L1's ownership change on December 31, Year 6. See §§ 1.1502–96T(a) and 1.1502–91T(c)(2). C's purchase of all the P stock causes an ownership change of P, and therefore the P loss group, on April 30, Year 7, with respect to L1's Year 3 loss. Accordingly, a consolidated section 382 limitation based on the value of the P stock immediately before the ownership change limits the amount of consolidated taxable income of the P group for any post-change year that may be offset by L1's Year 3 loss.

(c) *Built-in gains and losses.* As the context may require, the principles of §§ 1.1502–91T(g) and (h) and 1.1502–93T(c) (relating to built-in gains and losses) apply to a new loss member on a separate entity basis. See § 1.1502–91T(g)(3).

(d) *Information statements.* The common parent of a consolidated group that has a new loss member subject to paragraph (b)(1) of this section during a consolidated return year must file the information statement required by § 1.382–2T(a)(2)(ii) because of any owner shift, equity structure shift, or issuance or transfer of an option with respect to the new loss member. Instead of filing a separate statement for each new loss member the common parent may file a single statement described in § 1.382–2T(a)(2)(ii) with respect to the stock ownership of the common parent (which is treated as a loss corporation). In addition to the information concerning stock ownership of the common parent, the single statement must identify each new loss member and state which new loss members, if any, have had ownership changes during the consolidated return year. The new loss member is, however, required to maintain the records necessary to determine if it has an ownership change. This paragraph (d) applies with respect to the attributes of a new loss member until an event occurs which ends separate tracking under § 1.1502–96T(a). After that time, the information statement described in § 1.1502–92T(e)(1) must be filed with respect to these attributes.

§ 1.1502–95T Rules on ceasing to be a member of a consolidated group (or loss subgroup) (temporary).

(a) *In general*—(1) *Consolidated group.* This section provides rules for applying section 382 on or after the day that a member ceases to be a member of a consolidated group (or loss subgroup). The rules concern how to determine whether an ownership change occurs with respect to losses of the member, and how a consolidated section 382 limitation (or subgroup section 382 limitation) is apportioned to the member. As the context requires, a reference in this section to a loss group, a member, or a corporation also includes a reference to a loss subgroup, and a reference to a consolidated section 382 limitation also includes a reference to a subgroup section 382 limitation.

(2) Election by common parent. Only the common parent (not the loss subgroup parent) may make the election under paragraph (c) of this section to apportion either a consolidated section 382 limitation or a subgroup section 382 limitation.

(3) *Coordination with §§ 1.1502–91T through 1.1502–93T.* For rules regarding the determination of whether there is an ownership change of a loss subgroup and the computation of a subgroup section 382 limitation following such an ownership change, see §§ 1.1502–91T through 1.1502–93T.

(b) *Separate application of section 382 when a member leaves a consolidated group*—(1) *In general.* Except as provided in §§ 1.1502–91T through

1.1502–93T (relating to rules applicable to loss groups and loss subgroups), section 382 and the regulations thereunder apply to a corporation on a separate entity basis after it ceases to be a member of a consolidated group (or loss subgroup). Solely for purposes of determining whether a corporation has an ownership change—

(i) Any portion of a consolidated net operating loss that is apportioned to the corporation under § 1.1502–21T(b) is treated as a net operating loss of the corporation beginning on the first day of the taxable year in which the loss arose;

(ii) The testing period may include the period during which (or before which) the corporation was a member of the group (or loss subgroup); and

(iii) Except to the extent provided in § 1.1502–20(g) (relating to reattributed losses), the day it ceases to be a member of a consolidated group is treated as a testing date of the corporation within the meaning of § 1.382–2(a)(4).

(2) *Effect of a prior ownership change of the group.* If a loss group has had an ownership change under § 1.1502–92T before a corporation ceases to be a member of a consolidated group (the former member)—

(i) Any pre-change consolidated attribute that is subject to a consolidated section 382 limitation continues to be treated as a pre-change loss with respect to the former member after the attribute is apportioned to the former member;

(ii) The former member's section 382 limitation with respect to such attribute is zero except to the extent the common parent apportions under paragraph (c) of this section all or a part of the consolidated section 382 limitation to the former member;

(iii) The testing period for determining a subsequent ownership change with respect to such attribute begins no earlier than the first day following the loss group's most recent change date; and

(iv) As generally provided under section 382, an ownership change of the former member that occurs on or after the day it ceases to be a member of a loss group may result in an additional, lesser limitation amount with respect to such loss.

(3) *Application in the case of a loss subgroup.* If two or more former members are included in the same loss subgroup immediately after they cease to be members of a consolidated group, the principles of paragraphs (b) and (c) of this section apply to the loss subgroup. Therefore, for example, an apportionment by the common parent under paragraph (c) of this section is made to the loss subgroup rather than separately to its members.

(4) *Examples.* The following examples illustrate the principles of this paragraph (b).

Example 1. Treatment of departing member as a separate corporation throughout the testing period. (a) A owns all the L stock. L owns all the stock of L1 and L2. The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 3. On January 12, Year 2, A sells 30 percent of the L stock to B. On February 7, Year 3, L sells 40 percent of the L2 stock to C, and L2 ceases to be a member of the group. A portion of the Year 1 consolidated net operating loss is apportioned to L2 under § 1.1502–21T(b) and is carried to L2's first separate return year, which ends December 31, Year 3. The following is a graphic illustration of these facts:

(b) Under paragraph (b)(1) of this section, L2 is a loss corporation on February 7, Year 3. Under paragraph (b)(1)(iii) of this section, February 7, Year 3, is a testing date. Under paragraph (b)(1)(ii) of this section, the testing period for L2 with respect to this testing date commences on January 1, Year 1, the first day of the taxable year in which the portion of the consolidated net operating loss apportioned to L2 arose. Therefore, in determining whether L2 has an ownership change on February 7, Year 3, B's purchase of 30 percent of the L stock and C's purchase of 40 percent of the L2 stock are each owner shifts. L2 has an ownership change under section 382(g) and § 1.382–2T because B and C have increased their ownership interests in L2 by 18 and 40 percentage points, respectively, during the testing period.

Example 2. Effect of prior ownership change of loss group. (a) L owns all the L1 stock and L1 owns all the L2 stock. The L loss group had an ownership change under § 1.1502–92T in Year 2 with respect to a consolidated net operating loss arising in Year 1 and carried over to Year 2 and Year 3. The consolidated section 382 limitation computed solely on the basis of the value of the stock of L is $100. On December 31, Year 2, L1 sells 25 percent of the stock of L2 to B. L2 is apportioned a portion of the Year 1 consolidated net operating loss which it carries over to its first separate return year ending after December 31, Year 2. L2's separate section 382 limitation with respect to this loss is zero unless L elects to apportion all or a part of the consolidated section 382 limitation to L2. (See paragraph (c) of this section for rules regarding the apportionment of a consolidated section 382 limitation.) L apportions $50 of the consolidated section 382 limitation to L2.

(b) On December 31, Year 3, L1 sells its remaining 75 percent stock interest in L2 to C, resulting in an ownership change of L2. L2's section 382 limitation computed on the change date with respect to the value of its stock is $30. Accordingly, L2's section 382 limitation for post-change years ending after December 31, Year 3, with respect to its pre-change losses, including the consolidated net operating losses apportioned to it from the L group, is $30, adjusted as required by section 382 and the regulations thereunder.

(c) *Apportionment of a consolidated section 382 limitation*—(1) *In general.* The common parent may elect to apportion all or any part of a consolidated section 382 limitation to a former member (or loss subgroup). See paragraph (e) of this section for the time and manner of making the election to apportion.

(2) *Amount of apportionment.* The common parent may apportion all or part of each element of the consolidated section 382 limitation determined under § 1.1502–93T. For this purpose, the consolidated section 382 limitation consists of two elements—

(i) The value element, which is the element of the limitation determined under section 382(b)(1) (relating to value multiplied by the long-term tax-exempt rate) without regard to such adjustments as those described in section 382(b)(2) (relating to the carryforward of unused section 382 limitation), section 382(b)(3)(B) (relating to the section 382 limitation for the post-change year that includes the change

date), section 382(h) (relating to built-in gains and section 338 gains), and section 382(m)(2) (relating to short taxable years); and

(ii) The adjustment element, which is so much (if any) of the limitation for the taxable year during which the former member ceases to be a member of the consolidated group that is attributable to a carryover of unused limitation under section 382(b)(2) or to recognized built-in gains under 382(h).

(3) E*ffect of apportionment on the consolidated section 382 limitation.* The value element of the consolidated section 382 limitation for any post-change year ending after the day that a former member (or loss subgroup) ceases to be a member(s) is reduced to the extent that it is apportioned under this paragraph (c). The consolidated section 382 limitation for the post-change year in which the former member (or loss subgroup) ceases to be a member(s) is also reduced to the extent that the adjustment element for that year is apportioned under this paragraph (c).

(4) *Effect on corporations to which the consolidated section 382 limitation is apportioned.* The amount of the value element that is apportioned to a former member (or loss subgroup) is treated as the amount determined under section 382(b)(1) for purposes of determining the amount of that corporation's (or loss subgroup's) section 382 limitation for any taxable year ending after the former member (or loss subgroup) ceases to be a member(s). Appropriate adjustments must be made to the limitation based on the value element so apportioned for a short taxable year, carryforward of unused limitation, or any other adjustment required under section 382. The adjustment element apportioned to a former member (or loss subgroup) is treated as an adjustment under section 382(b)(2) or section 382(h), as appropriate, for the first taxable year after the member (or members) ceases to be a member (or members).

(5) *Deemed apportionment when loss group terminates.* If a loss group terminates, to the extent the consolidated section 382 limitation is not apportioned under paragraph (c)(1) of this section, the consolidated section 382 limitation is deemed to be apportioned to the loss subgroup that includes the common parent, or, if there is no loss subgroup that includes the common parent immediately after the loss group terminates, to the common parent. A loss group terminates on the first day of the first taxable year that is a separate return year with respect to each member of the former loss group.

(6) *Appropriate adjustments when former member leaves during the year.* Appropriate adjustments are made to the consolidated section 382 limitation for the consolidated return year during which the former member (or loss subgroup) ceases to be a member(s) to reflect the inclusion of the former member in the loss group for a portion of that year.

(7) *Examples.* The following examples illustrate the principles of this paragraph (c).

Example 1. Consequence of apportionment. (a) L owns all the L1 stock and L1 owns all the L2 stock. The L group has a $200 consolidated net operating loss arising in Year 1 that is carried over to Year 2. At the close of December 31, Year 1, the group has an ownership change under § 1.1502–92T. The ownership change results in a consolidated section 382 limitation of $10 based on the value of the stock of the group. On August 29, Year 2, L1 sells 30 percent of the stock of L2 to A. L2 is apportioned $90 of the group's $200 consolidated net operating loss under § 1.1502–21T(b). L, the common parent, elects to apportion $6 of the consolidated section 382 limitation to L2. The following is a graphic illustration of these facts:

(b) For its separate return years ending after August 29, Year 2 (other than the taxable year ending December 31, Year 2), L2's section 382 limitation with respect to the $90 of the group's net operating loss apportioned to it is $6, adjusted, as appropriate, for any short taxable year, unused section 382 limitation, or other adjustment. For its consolidated return years ending after August 29, Year 2, (other than the year ending December 31, Year 2) the L group's consolidated section 382 limitation with respect to the remaining $110 of pre-change consolidated attribute is $4 ($10 minus the $6 value element apportioned to L2), adjusted, as appropriate, for any short taxable year, unused section 382 limitation, or other adjustment.

(c) For the L group's consolidated return year ending December 31, Year 2, the value element of its consolidated section 382 limitation is increased by $4 (rounded to the nearest dollar), to account for the period during which L2 was a member of the L group ($6, the consolidated section 382 limitation apportioned to L2, times 241/365, the ratio of the number of days during Year 2 that L2 is a member of the group to the number of days in the group's consolidated return year). See paragraph (c)(6) of this section. Therefore, the value element of the consolidated section 382 limitation for Year 2 of the L group is $8 (rounded to the nearest dollar).

(d) The section 382 limitation for L2's short taxable year ending December 31, Year 2, is $2 (rounded to the nearest dollar), which is the amount that bears the same relationship to $6, the value element of the consolidated section 382 limitation apportioned to L2, as the number of days during that short taxable year, 124 days, bears to 365. See § 1.382–4(c).

Example 2. Consequence of no apportionment. The facts are the same as in *Example 1*, except that L does not elect to apportion any portion of the consolidated section 382 limitation to L2. For its separate return years ending after August 29, Year 2, L2's section 382 limitation with respect to the $90 of the group's pre-change consolidated attribute apportioned to L2 is zero under paragraph (b)(2)(ii) of this section. Thus, the $90 consolidated net operating loss apportioned to L2 cannot offset L2's taxable income in any of its separate return years ending after August 29, Year 2. For its consolidated return years ending after August 29, Year 2, the L group's consolidated section 382 limitation with respect to the remaining $110 of pre-change consolidated attribute is $10, adjusted, as appropriate, for any short taxable year, unused section 382 limitation, or other adjustment.

Example 3. Apportionment of adjustment element. The facts are the same as in *Example 1*, except that L2 ceases to be a member of the L group on August 29, Year 3, and the L group has a $4 carryforward of an unused consolidated section 382 limitation (under section 382(b)(2)) to the 1993 consolidated return year. The carryover of unused limitation increases the consolidated section 382 limitation for the Year 3 consolidated return year from $10 to $14. L may elect to apportion all or any portion of the $10 value element and all or any portion of the $4 adjustment element to L2.

(d) *Rules pertaining to ceasing to be a member of a loss subgroup*—(1) *In general.* A corporation ceases to be a member of a loss subgroup—

(i) On the first day of the first taxable year for which it files a separate return; or

(ii) The first day that it ceases to bear a relationship described in section 1504(a)(1) to the loss subgroup parent (treating for this purpose the loss subgroup parent as the common parent described in section 1504(a)(1)(A)).

(2) *Examples.* The principles of this paragraph (d) are illustrated by the following examples.

Example 1. Basic case. (a) P owns all the L stock, L owns all the L1 stock and L1 owns all the L2 stock. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. On December 11, Year 2, P sells all the stock of L to corporation M. Each of L, L1, and L2 is apportioned a portion of the Year 1 consolidated net operating loss, and thereafter each joins with M in filing consolidated returns. Under § 1.1502–92T, the L loss subgroup has an ownership change on December 11, Year 2. The L loss subgroup has a subgroup section 382 limitation of $100. The following is a graphic illustration of these facts:

as a pre-change loss of L2 for its separate return years ending after May 22, Year 3. Under paragraphs (a)(2) and (b)(2) of this section, the separate section 382 limitation with respect to this loss is zero unless M elects to apportion all or a part of the subgroup section 382 limitation of the L loss subgroup to L2.

Example 2. Formation of a new loss subgroup. The facts are the same as in *Example 1*, except that A purchases 40 percent of the L1 stock from L rather than purchasing L2 stock from L1. L1 and L2 file a consolidated return for their first taxable year ending after May 22, Year 3, and each of L1 and L2 carries over a part of the net operating loss of the P group that arose in Year 1. Under paragraph (d)(1) of this section, L1 and L2 cease to be members of the L loss subgroup on May 22, Year 3. The net operating losses carried over from the P group are treated as pre-change subgroup attributes of the loss subgroup composed of L1 and L2. The subgroup section 382 limitation with respect to those losses is zero unless M elects to apportion all or part of the subgroup section 382 limitation of the L loss subgroup to the L1 loss subgroup. The following is a graphic illustration of these facts:

(b) On May 22, Year 3, L1 sells 40 percent of the L2 stock to A. L2 carries over a portion of the P group's net operating loss from Year 1 to its separate return year ending December 31, Year 3. Under paragraph (d)(1) of this section, L2 ceases to be a member of the L loss subgroup on May 22, Year 3, which is both (1) the first day of the first taxable year for which it files a separate return and (2) the day it ceases to bear a relationship described in section 1504(a)(1) to the loss subgroup parent, L. The net operating loss of L2 that is carried over from the P group is treated

Example 3. Ceasing to bear a section 1504(a)(1) relationship to a loss subgroup parent. (a) A owns all the stock of P, and P owns all the stock of L1 and L2. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 3 and Year 4. Corporation M acquires all the stock of P on November 11, Year 3, and P, L1, and L2 thereafter file consolidated returns with M. M's acquisition results in an ownership change of the P loss subgroup under § 1.1502–92T(b)(1)(ii). The following is a graphic illustration of these facts:

(b) P distributes the L2 stock to M on October 7, Year 4. L2 ceases to be a member of the P loss subgroup on October 7, Year 4, the first day that it ceases to bear the relationship described in section 1504(a)(1) to P, the P loss subgroup parent. See paragraph (d)(1)(ii) of this section. Thus, the section 382 limitation with respect to the pre-change subgroup attributes attributable to L2 is zero except to the extent M elects to apportion all or a part of the subgroup section 382 limitation of the P loss subgroup to L2.

Example 4. Relationship through a successor. The facts are the same as in *Example 3*, except that, instead of P's distributing the stock of L2, L2 merges into L1 on October 7, Year 4. L1 (as successor to L2 in the merger within the meaning of § 1.382–2T(f)(4)) continues to bear a relationship described in section 1504(a)(1) to P, the loss subgroup parent. Thus, L2 does not cease to be a member of the P loss subgroup as a result of the merger.

(e) *Filing the election to apportion—*(1) *Form of the election to apportion.* An election under paragraph (c) of this

section must be made by the common parent. The election must be made in the form of the following statement: ''THIS IS AN ELECTION UNDER § 1.1502–95T OF THE INCOME TAX REGULATIONS TO APPORTION ALL OR PART OF THE [insert either CONSOLIDATED SECTION 382 LIMITATION or SUBGROUP SECTION 382 LIMITATION, as appropriate] TO [insert name and E.I.N. of the corporation (or the corporations that compose a new loss subgroup) to which allocation is made]. The declaration must also include the following information, as appropriate—

(i) The date of the ownership change that resulted in the consolidated section 382 limitation (or subgroup section 382 limitation);

(ii) The amount of the consolidated section 382 limitation (or subgroup section 382 limitation) for the taxable year during which the former member (or new loss subgroup) ceases to be a member of the consolidated group (determined without regard to any apportionment under this section;

(iii) The amount of the value element and adjustment element of the consolidated section 382 limitation (or subgroup section 382 limitation) that is apportioned to the former member (or new loss subgroup) pursuant to paragraph (c) of this section; and

(iv) The name and E.I.N. of the common parent making the apportionment.

(2) *Signing of the election.* The election statement must be signed by both the common parent and the former member (or, in the case of a loss subgroup, the common parent and the loss subgroup parent) by persons authorized to sign their respective income tax returns.

(3) *Filing of the election.* The election statement must be filed by the common parent of the group that is apportioning the consolidated section 382 limitation (or the subgroup section 382 limitation) with its income tax return for the taxable year in which the former member (or new loss subgroup) ceases to be a member. The common parent must also deliver a copy of the statement to the former member (or the members of the new loss subgroup) on or before the day the group files its income tax return for the consolidated return year that the former member (or new loss subgroup) ceases to be a member. A copy of the statement must be attached to the first return of the former member (or the first return in which the members of a new loss subgroup join) that is filed after the close of the consolidated return year of the group of which the former member (or the members of a new loss subgroup) ceases to be a member.

(4) *Revocation of election.* An election statement made under paragraph (c) of this section is revocable only with the consent of the Commissioner.

§ 1.1502–96T Miscellaneous rules (temporary).

(a) *End of separate tracking of losses*—(1) *Application.* This paragraph (a) applies to a member (or a loss subgroup) with a net operating loss carryover that arose (or is treated under § 1.1502–21T(c) as arising) in a SRLY (or a net unrealized built-in gain or loss determined at the time that the member (or loss subgroup) becomes a member of the consolidated group if there is—

(i) An ownership change of the member (or loss subgroup in connection with, or after, becoming a member of the group; or

(ii) A period of 5 consecutive years following the day that the member (or loss subgroup) becomes a member of a group during which the member (or loss subgroup) has not had an ownership change.

(2) *Effect of end of separate tracking.* If this paragraph (a) applies with respect to a member (or loss subgroup), then, starting on the day after the earlier of the change date (but not earlier than the day the member (or loss subgroup) becomes a member of the consolidated group) or the last day of the 5 consecutive year period described in paragraph (a)(1)(ii) of this section, the member's net operating loss carryover that arose (or is treated under § 1.1502–21T(c) as arising) in a SRLY, is treated as described in § 1.1502–91T(c)(1)(i). Also, the member's separately computed net unrealized built-in gain or loss is included in the determination whether the group has a net unrealized built-in gain or loss. The preceding sentences also apply for purposes of determining whether there is an ownership change with respect to such attributes following such change date (or earlier day) or 5 consecutive year period. Thus, for example, starting the day after the change date or the end of the 5 consecutive year period—

(i) The consolidated group which includes the new loss member or loss subgroup is no longer required to separately track owner shifts of the stock of the new loss member or loss subgroup parent to determine if an ownership change occurs with respect to the attributes of the new loss member or members included in the loss subgroup;

(ii) The group includes the member's attributes in determining whether it is a loss group under § 1.1502–91T(c);

(iii) There is an ownership change with respect to such attributes only if the group is a loss group and has an ownership change; and

(iv) If the group has an ownership change, such attributes are pre-change consolidated attributes subject to the loss group's consolidated section 382 limitation.

(3) *Continuing effect of end of separate tracking.* As the context may require, a current group determines which of its members are included in a loss subgroup on any testing date by taking into account the application of this section in the former group. See the example in § 1.1502–91T(f)(2).

(4) *Special rule for testing period.* For purposes of determining the beginning of the testing period for a loss group, the member's (or loss subgroup's) net operating loss carryovers (or net unrealized built-in gain or loss) described in paragraph (a)(2) of this section are considered to arise—

(i) in a case described in paragraph (a)(1)(i) of this section, in a taxable year that begins not earlier than the later of the day following the change date or the day that the member becomes a member of the group; and

(ii) in a case described in paragraph (a)(1)(ii) of this section, in a taxable year that begins 3 years before the end of the 5 consecutive year period.

(5) *Limits on effects of end of separate tracking.* The rule contained in this paragraph (a) applies solely for purposes of §§ 1.1502–91T through 1.1502–95T and this section (other than paragraph (b)(2)(ii)(B) of this section (relating to the definition of pre-change attributes of a subsidiary)) and § 1.1502–98T, and not for purposes of other provisions of the consolidated return regulations, including, for example, §§ 1.1502–15T and 1.1502–21T (relating to the consolidated net operating loss deduction). See also paragraph (c) of this section for the continuing effect of an ownership change with respect to pre-change attributes.

(b) *Ownership change of subsidiary*—(1) *Ownership change of a subsidiary because of options or plan*

or arrangement. Notwithstanding § 1.1502–92T, a subsidiary may have an ownership change for purposes of section 382 with respect to its attributes which a group or loss subgroup includes in making a determination under § 1.1502–91T(c)(1) (relating to the definition of loss group) or § 1.1502–91T(d) (relating to the definition of loss subgroup). The subsidiary has such an ownership change if it has an ownership change under the principles of § 1.1502–95T(b) and section 382 and the regulations thereunder (determined on a separate entity basis by treating the subsidiary as not being a member of a consolidated group) in the event of—

(i) The deemed exercise under § 1.382–4(d) of an option or options (other than an option with respect to stock of the common parent) held by a person (or persons acting pursuant to a plan or arrangement) to acquire more than 20 percent of the stock of the subsidiary; or

(ii) An increase by 1 or more 5-percent shareholders, acting pursuant to a plan or arrangement to avoid an ownership change of a subsidiary, in their percentage ownership interest in the subsidiary by more than 50 percentage points during the testing period of the subsidiary through the acquisition (or deemed acquisition pursuant to § 1.382–4(d)) of ownership interests in the subsidiary and in higher-tier members with respect to the subsidiary.

(2) *Effect of the ownership change*—(i) *In general.* If a subsidiary has an ownership change under paragraph (b)(1) of this section, the amount of consolidated taxable income for any post-change year that may be offset by the pre-change losses of the subsidiary shall not exceed the section 382 limitation for the subsidiary. For purposes of this limitation, the value of the subsidiary is determined solely by reference to the value of the subsidiary's stock.

(ii) *Pre-change losses.* The pre-change losses of a subsidiary are—

(A) Its allocable part of any consolidated net operating loss which is attributable to it under § 1.1502–21T(b) (determined on the last day of the consolidated return year that includes the change date) that is not carried back and absorbed in a taxable year prior to the year including the change date;

(B) Its net operating loss carryovers that arose (or are treated under § 1.1502–21T(c) as having arisen) in a SRLY; and

(C) Its recognized built-in loss with respect to its separately computed net unrealized built-in loss, if any, determined on the change date.

(3) *Coordination with §§ 1.1502–91T, 1.1502–92T, and 1.1502–94T.* If an increase in percentage ownership interest causes an ownership change with respect to an attribute under this paragraph (b) and under § 1.1502–92T on the same day, the ownership change is considered to occur only under § 1.1502–92T and not under this paragraph (b). See § 1.1502–94T for anti-duplication rules relating to value.

(4) *Example.* The following example illustrates paragraph (b)(1)(ii) of this section.

Plan to avoid an ownership change of a subsidiary. (a) L owns all the stock of L1, L1 owns all the stock of L2, L2 owns all the stock of L3, and L3 owns all the stock of L4. The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. L has assets other than its L1 stock with a value of $900. L1, L2, and L3 own no assets other than their L2, L3, and L4 stock. L4 has assets with a value of $100. During Year 2, A, B, C, and D, acting pursuant to a plan to avoid an ownership change of L4, acquire the following ownership interests in the members of the L loss group: (A) on September 11, Year 2, A acquires 20 percent of the L1 stock from L and B acquires 20 percent of the L2 stock from L1; and (B) on September 20, Year 2, C acquires 20 percent of the stock of L3 from L2 and D acquires 20 percent of the stock of L4 from L3. The following is a graphic illustration of these facts:

(b) The acquisitions by A, B, C, and D pursuant to the plan have increased their respective percentage ownership interests in L4 by approximately 10, 13, 16, and 20 percentage points, for a total of approximately 59 percentage points during the testing period. This more than 50 percentage point increase in the percentage ownership interest in L4 causes an ownership change of L4 under paragraph (b)(2) of this section.

(c) *Continuing effect of an ownership change.* A loss corporation (or loss subgroup) that is subject to a limitation under section 382 with respect to its pre-change losses continues to be subject to the limitation regardless of whether it becomes a member or ceases to be a member of a consolidated group. See § 1.382–5T(d) (relating to successive ownership changes and absorption of a section 382 limitation).

§ 1.1502–97T Special rules under section 382 for members under the jurisdiction of a court in a title 11 or similar case (temporary). [Reserved]

§ 1.1502–98T Coordination with section 383 (temporary).

The rules contained in §§ 1.1502–91T through 1.1502–96T also apply for purposes of section 383, with appropriate adjustments to reflect that section 383 applies to credits and net capital losses. Similarly, in the case of net capital losses, general business credits, and excess foreign taxes that are pre-change attributes, § 1.383–1 applies the principles of §§ 1.1502–91T through 1.1502–96T. For example, if a loss group has an ownership change under § 1.1502–92T and has a carryover of unused general business credits from a pre-change consolidated return year to a post-change consolidated return year, the amount of the group's regular tax liability for the post-change year that can be offset by the carryover cannot exceed the consolidated section 383 credit limitation for that post-change year, determined by applying the principles of §§ 1.383–1(c)(6) and 1.1502–93T (relating to the computation of the consolidated section 382 limitation).

§ 1.1502–99T Effective dates (temporary).

(a) *Effective date.* Sections 1.1502–91T through 1.1502–96T and 1.1502–98T apply to any testing date on or after January 1, 1997. Sections 1.1502–94T through 1.1502–96T also apply on any date on or after January 1, 1997, on which a corporation becomes a member of a group or on which a corporation ceases to be a member of a loss group (or a loss subgroup).

(b) *Testing period may include a period beginning before January 1, 1997.* A testing period for purposes of §§ 1.1502–91T through 1.1502–96T and 1.1502–98T may include a period beginning before January 1, 1997. Thus, for example, in applying § 1.1502–92T(b)(1)(i) (relating to the determination of an ownership change of a loss group), the determination of the lowest percentage ownership interest of any 5-percent shareholder of the common parent during a testing period ending on a testing date occurring on or after January 1, 1997, takes into account the period beginning before January 1, 1997, except to the extent that the period is more than 3 years before the testing date or is otherwise before the beginning of the testing period. See § 1.1502–92T(b)(1).

(c) *Transition rules*—(1) *Methods permitted*—(i) *In general.* For the period ending before January 1, 1997, a consolidated group is permitted to use any method described in paragraph (c)(2) of this section which is consistently applied to determine if an ownership change occurred with respect to a consolidated net operating loss, a net operating loss carryover (including net operating loss carryovers arising in SRLYs), or a net unrealized built-in loss. If an ownership change occurred during that period, the group is also permitted to use any method described in paragraph (c)(2) of this section which is consistently applied to compute the amount of the section 382 limitation that applies to limit the use of taxable income in any post-change year ending before, on, or after January 1, 1997. The preceding sentence does not preclude the imposition of an additional, lesser limitation due to a subsequent ownership change nor, except as provided in paragraph (c)(1)(iii) of this section, does it permit the beginning of a new testing period for the loss group.

(ii) *Adjustments to offset excess limitation.* If an ownership change occurred during the period ending before January 1, 1997, and a method described in paragraph (c)(2) of this section was not used for a post-change year, the members (or group) must reduce the section 382 limitation for post-change years for which an income tax return is filed after January 1, 1997, to offset, as quickly as possible, the effects of any section 382 limitation that members took into account in excess of the amount that would have been allowable under §§ 1.1502–91T through 1.1502–96T and 1.1502–98T.

(iii) *Coordination with effective date.* Notwithstanding that a group may have used a method described in paragraph (c)(2)(ii) or (iii) of this section for the period before January 1, 1997, §§ 1.1502–91T through 1.1502–96T and 1.1502–98T apply to any testing date occurring on or after January 1, 1997, for purposes of determining whether there is an ownership change with respect to any losses and, if so, the collateral consequences. Any ownership change of a member other than the common parent pursuant to a method described in paragraph (c)(2)(ii) or (iii) of this section does not cause a new testing period of the loss group to begin for purposes of applying § 1.1502–92T on or after January 1, 1997.

(2) *Permitted methods.* The methods described in this paragraph (c)(2) are:

(i) A method that does not materially differ from the rules in §§ 1.1502–91T through 1.1502–96T and 1.1502–98T (other than those in § 1.1502–95T(c) (relating to the apportionment of a section 382 limitation) as they would apply to a corporation that ceases to be a member of the group before January 1, 1997). As the context requires, the method must treat references to rules in current regulations as references to rules in regulations generally effective for taxable years before January 1, 1997. Thus, for example, the taxpayer must treat a reference to § 1.382–4(d) (relating to options) as a reference to § 1.382–2T(h)(4) for any testing date to which § 1.382–2T(h)(4) applies. Similarly, a reference to § 1.1502–21T(c) may be a reference to § 1.1502–21A(c), as appropriate. Furthermore, the method must treat all corporations that were affiliated on January 1, 1987, and continuously thereafter as having met the 5 consecutive year requirement of § 1.1502–91T(d)(2)(i) on any day before January 1, 1992, on which the determination of net unrealized built-in gain or loss of a loss subgroup is made;

(ii) A reasonable application of the rules in section 382 and the regulations thereunder applied to each member on a separate entity basis, treating each member's allocable part of a consolidated net operating loss which is attributable to it under § 1.1502–21T(b) as a net operating loss of that member and applying rules similar to § 1.382–8T to avoid duplication of value in computing the section 382 limitation for the member (see § 1.382–8T(h) (relating to the effective date and transition rules regarding controlled groups)); or

(iii) A method approved by the Commissioner upon application by the common parent.

(d) *Amended returns.* A group may file an amended return in connection with an ownership change occurring before January 1, 1997, to modify the amount of a section 382 limitation with respect to a consolidated net operating loss, a net operating loss carryover (including net operating loss carryovers arising in SRLYs), or a recognized built-in loss (or gain) only if it files amended returns:

(1) For the earliest taxable year ending after December 31, 1986, in which it had an ownership change, if any, under § 1.1502–92T;

(2) For all subsequent taxable years for which returns have already been filed as of the date of the amended return;

(3) The modification with respect to all members for all taxable years ending in 1987 and thereafter complies with §§ 1.1502–91T through 1.1502–96T and 1.1502–98T; and

(4) The amended return(s) permitted by the applicable statute of limitations is/are filed before Tuesday, September 24, 1996.

(e) *Section 383.* This section also applies for the purposes of section 383, with appropriate adjustments to reflect that section 383 applies to credits and net capital losses.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read in part as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In § 602.101, paragraph (c) is amended by adding an entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified or described	Current OMB control No.
* * * * *	
1.1502–95T	1545–1218
* * * * *	

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved May 31, 1996.

Leslie Samuels,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 26, 1996, 8:45 a.m., and published in the issue of the Federal Register for June 27, 1996, 61 F.R. 33335)

Part III. Administrative, Procedural, and Miscellaneous

Instructions for Filing Claims for Refund of Insurance Premium Excise Tax Based on the U.S. Supreme Court's Opinion in *United States v. IBM*

Notice 96–37

PURPOSE

This notice provides instructions for filing claims for refund of insurance premium excise tax imposed by section 4371 of the Internal Revenue Code based on the Supreme Court's opinion in *United States v. International Business Machines Corp.*, 64 U.S.L.W. 4419 (June 10, 1996).

BACKGROUND

Section 4371(1) of the Code imposes a tax on each policy of insurance or reinsurance issued by any foreign insurer or reinsurer with respect to casualty insurance that is issued to or for, or in the name of, an insured as defined in section 4372(d) of the Code. The rate of tax is 4 percent of the premium paid on the policy.

In *U.S. v. IBM*, the Supreme Court held that the tax imposed by section 4371(1) of the Internal Revenue Code of 1986 may not be applied to premiums paid with respect to insurance covering risks associated with goods actually in export transit from the U.S. The Supreme Court's decision was based on the Export Clause of the U.S. Constitution, Art. I, sec. 9, cl. 5.

PROCEDURE FOR CLAIMING REFUND OF INSURANCE PREMIUM EXCISE TAX

Any taxpayer requesting a refund of insurance premium excise tax based on the *U.S. v. IBM* opinion must file a Form 8849, Claim for Refund of Excise Taxes. Refunds relating to insurance premium excise tax based on the *U.S. v. IBM* opinion may not be claimed as a credit against any other tax liability, and this notice provides the only procedure for claiming a refund.

In addition to the information required by the Form 8849, a claim for refund must be accompanied by documentation establishing that the tax for which a refund is claimed was paid with respect to insurance covering only goods actually in export transit from the U.S. In the case of a policy covering risks in addition to goods in export transit, the claim for refund must be accompanied by documentation establishing the portion of the insurance excise tax attributable to premiums paid only for insuring goods in actual export transit from the U.S.

The following statement should be typed or clearly written at the top of the Form 8849:

CLAIM FOR REFUND OF INSURANCE PREMIUM EXCISE TAX AS A RESULT OF *U.S. V. IBM.*

Any Form 8849 requesting a refund of insurance premium excise tax should be submitted to the following address:

Internal Revenue Service Center
P.O. Box 21086
Philadelphia, PA 19114

DRAFTING INFORMATION

The principal author of this notice is Ed Williams of the Office of the Associate Chief Counsel (International). For further information regarding this notice, call Mr. Williams at (202) 874–1490 (not a toll-free number).

Weighted Average Interest Rate Update

Notice 96–38

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for June 1996 is 7.06 percent.

The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	90% to 108% Permissible Range	90% to 110% Permissible Range
July	1996	6.92	6.23 to 7.47	6.23 to 7.61

Drafting Information

The principal author of this notice is Donna Prestia of the Employee Plans Division. For further information regarding this notice, call (202) 622–6076 between 2:30 and 4:00 p.m. Eastern time (not a toll-free number). Ms. Prestia's number is (202) 622–7377 (also not a toll-free number).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Regulations Under Section 1502 of the Internal Revenue Code of 1986; Limitations on Net Operating Loss Carryforwards and Certain Built-in Losses and Credits Following an Ownership Change of a Consolidated Group

CO–25–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of prior proposed rule, notice of proposed rulemaking by cross-reference to temporary regulations, and notice of public hearing.

SUMMARY: On February 4, 1991, proposed rules under section 1502 were published in the **Federal Register** (CO–132–87; see 56 FR 4194; 1991–1 C.B. 728). A public hearing was held on April 8, 1991. The IRS and Treasury published Notice 91–27 (1991–2 C.B. 629) to advise of intended modifications to the proposed regulations. The February, 1991, proposed rules are withdrawn and these proposed regulations are issued in their place.

In TD 8678, page 11 in this issue of the Bulletin, the IRS is issuing temporary regulations regarding the operation of sections 382 and 383 of the Internal Revenue Code of 1986 (relating to limitations on net operating loss carryforwards and certain built-in losses and credits following an ownership change) with respect to consolidated groups. The text of those temporary regulations also serves as the text of these proposed regulations. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written comments must be received by Wednesday, September 25, 1996. Outlines of topics to be discussed at the public hearing scheduled for Thursday, October 17, 1996, at 10 a.m. must be received by Thursday, September 26, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (CO–25–96), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (CO–25–96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. The public hearing will be held in the NYU Classroom, Room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, David B. Friedel, (202) 622–7550; concerning submissions and the hearing, Evangelista Lee, (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under the control number 1545–1218. The collection requires a response from certain consolidated groups. The IRS requires the information described in Proposed § 1.1502–95(e) to assure that a section 382 limitation is properly determined in cases of corporations that cease to be members of a group.

Comments concerning the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC, 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP. Washington, DC, 20224. Comments on the collection of information should be received by Monday, August 26, 1996.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collection of information is in Proposed § 1.1502–95(e). That section permits an election with respect to the apportionment of a group section 382 limitation to a departing member. A statement evidencing the apportionment must be filed by the group and the departing member indicating relevant information regarding the apportionment. The likely respondents and/or recordkeepers are corporations that are members of certain consolidated groups. Responses to this collection of information are required to obtain a benefit (relating to the section 382 limition applicable to the departing member(s)).

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Estimated total annual reporting burden: 380 hours. The estimated annual burden per respondent varies from ten to thirty minutes, depending on individual circumstances, with an estimated average of fifteen minutes. Estimated number of respondents: 9,125. Estimated frequency of responses: once every six years.

Background

Temporary regulations in TD 8678, page 11 amend the Income Tax Regulations (26 CFR Part 1) under section 1502, relating to limitations on net operating loss carryforwards and certain built-in losses and credits following an ownership change with respect to consolidated groups. The final regulations that are proposed to be based on these proposed regulations would be added to part 1 of title 26 of the Code of Federal Regulations. Those final regulations would provide rules relating to limitations on net operating loss carryforwards and certain built-in losses following an ownership change.

For the text of these new temporary regulations, see TD 8678. The preamble to the temporary regulations explains the regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Thursday, October 17, 1996, at 10 a.m. in the NYU Classroom, Room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by Wednesday, September 25, 1996, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by Thursday, September 26, 1996.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting information

The principal author of the temporary regulations is David B. Friedel of the Office of Assistant Chief Counsel (Corporate), IRS. Other personnel from the IRS and Treasury participated in their development.

Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking that was published on January 29, 1991 (56 FR 4194) is withdrawn.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1502–91 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–92 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–93 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–94 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–95 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–96 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–98 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–99 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

* * *

Par. 2. Sections 1.1502–90 through 1.1502–99 are added to read as follows:

§ 1.1502–90 Table of contents.

§ 1.1502–91 Application of section 382 with respect to a consolidated group.

§ 1.1502–92 Ownership change of a loss group or a loss subgroup.

§ 1.1502–93 Consolidated section 382 limitation (or subgroup section 382 limitation.

§ 1.1502–94 Coordination with section 382 and the regulations thereunder when a corporation becomes a member of a consolidated group.

§ 1.1502–95 Rules on ceasing to be a member of a consolidated group (or loss subgroup).

§ 1.1502–96 Miscellaneous rules.

§ 1.1502–97 Special rules under section 382 for members under the jurisdiction of a court in a title 11 or similar case.

§ 1.1502–98 Coordination with section 383.

§ 1.1502–99 Effective dates.

[The text of the above proposed sections is the same as the text of § § 1.1502–90T through 1.1502–99T published elsewhere in this issue of the Bulletin.]

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 26, 1996, 8:45 a.m., and published in the issue of the Federal Register for June 27, 1996, 61 F.R. 33395)

Notice of Proposed Rulemaking and Notice of Public Hearing

Regulations Under Section 382 of the Internal Revenue Code of 1986; Application of Section 382 in Short Taxable Years and With Respect to Controlled Groups

CO–26–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of prior proposed rule, notice of proposed rulemaking by cross-reference to temporary regulations, and notice of public hearing.

SUMMARY: On January 29, 1991, proposed rules under section 382 of the Internal Revenue Code of 1986 (relating to limitations on net operating loss carryforwards and certain built-in losses following an ownership change) were filed with the Office of the **Federal Register** (CO–77–90; see 56 FR 4183; 1991–1 C.B. 749). The January, 1991, proposed rules are withdrawn and these proposed rules are issued in their place.

In TD 8679, page 4 in this issue of the Bulletin, the IRS is issuing temporary regulations relating to the application of section 382 in short taxable years and with respect to controlled groups. These regulations comply with the statutory direction under section 382(m) to prescribe such regulations. Additional rules amend certain aspects of § 1.382–2T relating principally to the separate tracking of the stock ownership of loss corporations that cease to exist following a merger or similar transactions.

The text of those temporary regulations also serves as the text of these proposed regulations. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written comments must be received by Wednesday, September 25, 1996. Outlines of topics to be discussed at the public hearing scheduled for Thursday, October 17, 1996, at 10 a.m. must be received by Thursday, September 26, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (CO–26–96), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to:

CC:DOM:CORP:R (CO–26–96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. The public hearing will be held in the NYU Classroom, Room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, David B. Friedel, (202) 622–7550; concerning submissions and the hearing, Evangelista Lee, (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under the control number 1545–1434. Proposed § 1.382–8(h) requires a response from certain corporations that are members of controlled groups. The IRS requires this information to assure compliance with section 382(m)(5) so that the value of a loss corporation that is a member of a controlled group is not taken into account more than once in computing a section 382 limitation.

Comments concerning the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC, 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP. Washington, DC, 20224. Comments on the collection of information should be received by Monday, August 26, 1996.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

Proposed § 1.382–8(h) provides that the loss corporation must file a statement signed by it and any other member of the controlled group that elects to restore value to it indicating relevant information regarding the election. The likely respondents and/or recordkeepers are corporations that are members of certain controlled groups. Responses to this collection of information are required to obtain a benefit (relating to the restoration of value for section 382 purposes).

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Estimated total annual reporting burden: 875 hours. The estimated annual burden per respondent varies from ten to thirty minutes, depending on individual circumstances, with an estimated average of fifteen minutes. Estimated number of respondents: 21,000. Estimated frequency of responses: once every six years.

Background

Temporary regulations in TD 8679, page 4 amend the Income Tax Regulations (26 CFR Part 1) under section 382 of the Internal Revenue Code of 1986. Among other changes, those regulations add temporary regulations § § 1.382–5T and 1.382–8T, and amend § 1.382–2T(f). The final regulations that are proposed to be based on these proposed regulations would be added to part 1 of title 26 of the Code of Federal Regulations. Those final regulations would provide rules relating to limitations on net operating loss carryforwards and certain built-in losses following an ownership change under section 382.

For the text of these new temporary regulations, see TD 8679. The preamble to the temporary regulations explains the regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Thursday, October 17, 1996, at 10 a.m. in the NYU Classroom, Room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by Wednesday, September 25, 1996, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by Thursday, September 26, 1996.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of the temporary regulations is David B. Friedel of the Office of Assistant Chief Counsel (Corporate), IRS. Other personnel from the IRS and Treasury participated in their development.

Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking that was published on January 29, 1991 (56 FR 4183) is withdrawn.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by revising the entry for § 1.382–2T and adding citations for § § 1.382–5 and 1.382–8 in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.382–2T also issued under 26 U.S.C. 382(g)(4)(C), (i), (k)(1) and (6), (l)(3), (m), and 26 U.S.C. 383.* * *

Section 1.382–5 also issued under 26 U.S.C. 382(m).* * *

Section 1.382–8 also issued under 26 U.S.C. 382(m).* * *

Par. 2. Section 1.382–1 is amended by revising the entries for § 1.382–2(a)(1)(iv), and adding § § 1.382–5 and 1.382–8 to read as follows:

§ 1.382–1 Table of contents.

* * * * *

§ 1.382–2 General rules for ownership change.

(a) * * *

(1) * * *

(iv) End of separate accounting for losses and credits of distributor or transferor loss corporation.

* * * * *

§ 1.382–5 Section 382 limitation.

(a) Scope.

(b) Computation of value.

(c) Short taxable year.

(d) Successive ownership changes and absorption of a section 382 limitation.

(1) In general.

(2) Recognized built-in gains and losses.

(3) Effective date.

(e) Controlled groups.

(f) Effective date.

* * * * *

§ 1.382–8 Controlled groups.

(a) Introduction.

(b) Controlled group loss and controlled group with respect to a controlled group loss.

(c) Computation of value.

(1) Reduction in value.

(2) Restoration of value.

(3) Reduction in value by the amount restored.

(4) Appropriate adjustments.

(5) Certain reductions in the value of members of a controlled group.

(d) No double reduction.

(e) Definitions and nomenclature.

(1) Definitions in § 1.382–2T.

(2) Controlled group.

(3) Component member.

(4) Predecessors and successors.

(f) Coordination between consolidated groups and controlled groups.

(g) Examples.

(h) Time and manner of filing election to restore.

(1) Statement required.

(2) Revocation of election.

(3) Filing by component member.

(i) [Reserved]

(j) Effective date.

(1) In general.

(2) Transition rule.

(3) Corporations that are not members on January 29, 1991.

(4) Amended returns.

Par. 3. Section 1.382–2 is amended as follows:

§ 1.382–2 General rules for ownership change.

[The text of the proposed amendments to paragraphs (e)(2)(iv), (f)(1)(i), (ii) and (iii), (f)(4), (f)(5), and (f)(18)(i) is the same as the text of the amendments to paragraphs (e)(2)(iv), (f)(1)(i), (ii) and (iii), (f)(4), (f)(5), and (f)(18)(i) of § 1.382–2T, published in TD 8679, page 4, in this issue of the Bulletin.]

Par. 4. Sections 1.382–5 and 1.382–8 are added to read as follows:

[The text of these proposed sections is the same as the text of § § 1.382–5T and 1.382–8T published in TD 8679, page 4, in this issue of the Bulletin.]

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 26, 1996, 8:45 a.m., and published in the issue of the Federal Register on June 27, 1996, 61 F.R. 33391)

Notice of Proposed Rulemaking and Notice of Public Hearing

Arbitrage Restrictions on Tax-Exempt Bonds

FI–28–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations on the arbitrage restrictions applicable to tax-exempt bonds issued by state and local governments. Changes to applicable law were made by the Tax Reform Act of 1986. These proposed regulations affect issuers of tax-exempt bonds and would provide guidance for complying with the arbitrage regulations.

DATES: Written comments must be received by September 25, 1996. Requests to speak (with outlines of oral comments) at a public hearing scheduled for Thursday, October 24, 1996, at 10 a.m. must be received by October 3, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (FI–28–96), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (FI–28–96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. The public hearing will be held in the Commissioner's Conference Room, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Loretta J. Finger, (202) 622–3980; concerning submissions and the hearing, Michael Slaughter, (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507).

Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collections of information should be received by August 26, 1996.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collections of information are in proposed § 1.148–5(d)(6)(v), (vi), and (vii). This information is required by the

IRS to verify compliance with section 148. This information will be used to establish a rebuttable presumption that a Treasury obligation is purchased at fair market value. The likely respondents and/or recordkeepers are state or local governments. Responses to this collection of information are required to establish a rebuttable presumption that a Treasury obligation is purchased at fair market value.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 25 U.S.C. 6103.

Estimated total annual reporting and recordkeeping burden: 2,400 hours.
The estimated annual burden per respondent/recordkeeper varies from 2 hours to 30 hours, depending on individual circumstances, with an estimated average of 6 hours.

Estimated number of respondents/ recordkeepers: 400.

Estimated annual frequency of responses: on occasion.

Background

This document contains proposed regulations amending the Income Tax Regulations (26 CFR part 1) under section 148 of the Internal Revenue Code to provide guidance on nonpurpose investments for purposes of arbitrage yield restrictions under section 148.

Explanation of Provisions

A. *Background of proposed regulations*

Section 148 provides rules concerning the use of proceeds of state and local bonds to acquire higher yielding investments. Section 148(a) provides that, except as otherwise permitted by section 148, interest on a state or local bond generally is tax-exempt only if the issuer invests bond proceeds at a yield not exceeding the bond yield. Section 148(f) provides, in general, that interest on a state or local bond is tax-exempt only if the issuer rebates to the United States certain earnings from investing bond proceeds at a yield exceeding the bond yield.

Section 1.148–6(c) provides that gross proceeds of an issue of bonds are not allocated to a payment for a nonpurpose investment in an amount greater than the fair market value of that investment on the purchase date. For this purpose only, the fair market value of a nonpurpose investment is adjusted to take into account qualified administrative costs allocable to that investment.

Regulations relating to the arbitrage yield restriction rules are in §§ 1.148–0 through 1.148–11 and in §§ 1.148–1T, 1.148–2T, 1.148–3T, 1.148–4T, 1.148–5T, 1.148–6T, 1.148–9T, 1.148–10T, and 1.148–11T. The proposed regulations would clarify and revise certain provisions of these regulations.

B. *Bona fide solicitation*

Section 1.148–5(d)(6)(iii) provides that the purchase price of a guaranteed investment contract is treated as its fair market value on the purchase date if the issuer makes a bona fide solicitation for a guaranteed investment contract that meets the requirements of that section. The proposed regulations would clarify that a solicitation for a guaranteed investment contract is rebuttably presumed to be bona fide if the following requirements are met: (i) if the issuer uses an agent to conduct the bidding process, the agent does not bid to provide the investment; (ii) all bidders have equal opportunity to bid so that, for example, no bidder is given the opportunity to review other bids (a last look) before bidding; and (iii) all bidders are reasonably competitive providers of investments of the type purchased.

C. *Rebuttable presumption for establishing fair market value*

Section 1.148–5(d)(6)(iii) provides a safe harbor for establishing fair market value for guaranteed investment contracts. The definition of guaranteed investment contract generally does not include the purchase of investments for an escrow for an advance refunding transaction.

The proposed regulations would provide a rebuttable presumption for establishing fair market value for United States Treasury obligations purchased other than directly from the United States Treasury. The proposed regulations would apply the principles underlying the safe harbor in the regulations for establishing fair market value for guaranteed investment contracts.

D. *Qualified administrative costs*

Section 1.148–5(e)(2)(i) provides in general that, in determining payments and receipts on nonpurpose investments, qualified administrative costs are taken into account. Thus, qualified administrative costs increase the payments for, or decrease the receipts from, the investments.

The proposed regulations would provide a special rule to determine qualified administrative costs for United States Treasury obligations purchased other than directly from the United States Treasury.

Proposed Effective Dates

The regulations are proposed to apply to bonds sold on or after the date 60 days after the adoption of final regulations. In addition, these regulations are proposed to apply after that date to permit an issuer to apply these regulations to bonds to which certain other regulations under section 148 apply that were sold prior to that date.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Thursday, October 24, 1996, at 10 a.m., in the Commissioner's Conference Room, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by September 25, 1996, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by October 3, 1996.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Loretta J. Finger, Office of Assistant Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.148–5 is amended by adding paragraphs (d)(6)(iv) through (d)(6)(viii) and (e)(2)(iv) to read as follows:

§ 1.148–5 Yield and valuation of investments.

* * * * *

(d) * * *

(6) * * *

(iv) *Rebuttable presumption for establishing that a solicitation for a guaranteed investment contract is bona fide.* For purposes of paragraph (d)(6)(iii)(A) of this section, a solicitation for a guaranteed investment contract is rebuttably presumed to be bona fide if the other requirements of paragraph (d)(6)(iii) of this section and the following requirements are satisfied:

(A) If the issuer uses an agent to conduct the bidding process, the agent does not bid to provide the investment;

(B) All bidders have equal opportunity to bid so that, for example, no bidder is given the opportunity to review other bids (a last look) before bidding; and

(C) All bidders are reasonably competitive providers of investments of the type purchased.

(v) *Rebuttable presumption for establishing fair market value for United States Treasury obligations purchased other than directly from the United States Treasury.* The purchase price of United States Treasury obligations that are purchased other than directly from the United States Treasury is rebuttably presumed to be the fair market value on the purchase date if all of the following requirements are satisfied:

(A) The issuer conducts in good faith a solicitation for the purchase of Treasury obligations that meets the requirements of paragraphs (d)(6)(iv)(A) through (C) of this section, and the issuer receives at least three bona fide bids from providers that have no material financial interest in the issue. For this purpose, underwriters and financial advisors for an issue are considered to have a material financial interest in the issue.

(B) The issuer purchases the highest-yielding Treasury obligations for which a qualifying bid is made.

(C) The yield on the Treasury obligations purchased is not significantly less than the yield then available from the provider on reasonably comparable Treasury obligations offered to other persons for purchase on terms comparable to those offered to the issuer from a source of funds other than gross proceeds of tax-exempt bonds. If closely comparable forward prices are not offered to other persons for purchase from a source other than gross proceeds of tax-exempt bonds, a reasonable basis for this comparison may be by reference to implied forward prices for Treasury obligations based on standard financial formulas. In general, a certificate provided by an agent conducting the bidding process detailing this comparison establishes that this comparability standard is met.

(D) In no event is the yield on any Treasury obligation purchased less than the highest yield then available on a United States Treasury security — State and Local Government Series from the United States Department of the Treasury, Bureau of Public Debt, with the same maturity.

(E) The terms of the agreement to purchase the Treasury obligations are reasonable.

(F) The issuer retains the items enumerated in paragraphs (d)(vi) and (vii) of this section with the bond documents.

(vi) *Copies.* The items described in this paragraph (d)(vi) are a copy of each of the following—

(A) The purchase agreement or confirmation and a statement detailing any oral and other terms of the agreement;

(B) The receipt or other record of the amount actually paid by the issuer for the Treasury obligations, including a statement setting out the amount of any brokerage commission, broker fee, or bidding fee paid to or by the seller of the Treasury obligations; and

(C) Each bid that is received with respect to the solicitation of the Treasury obligations (clearly stamped to show date and time when the bid was received) and a description of the bidding procedure used.

(vii) *Statement.* The item described in this paragraph (d)(vii) is a statement from the issuer, dated as of the issue date of the bonds, certifying, under penalties of perjury, that—

(A) If the issuer used an agent to conduct the bidding process, the agent did not bid to provide the investment;

(B) All bidders had equal opportunity to bid so that, for example, no bidder had an opportunity to review other bids before bidding;

(C) All bidders are reasonably competitive sellers of Treasury obligations; and

(D) The issuer received at least three bona fide bids from providers that have no material financial interest in the issue. (viii) For purposes of paragraphs (d)(6)(v) through (vii) of this section, the term *issuer* means only the entity that actually issues the bonds and not a conduit borrower of the issuer.

(e) * * *

(2) * * *

(iv) *Special rule for United States Treasury obligations purchased other than directly from the United States Treasury.* For Treasury obligations purchased other than directly from the United States Treasury, a fee paid to a bidding agent is a qualified administrative cost only if the following requirements are satisfied:

(A) The fee must be reasonable. In general, a fee must be separately stated in order for the issuer to have a basis for determining that a fee is reasonable. The fee is presumed to be reasonable if it does not exceed .02 percent of the amount invested in Treasury obligations.

(B) The fee must be comparable to a fee that would be charged for a reasonably comparable investment of Treasury obligations if acquired with a source of funds other than gross proceeds of tax-exempt bonds. This comparability standard must be applied even if no identical investments are customarily acquired with a source of funds other than gross proceeds of tax-exempt bonds. In general, reference must be made to the bidding fees paid by investors that are not issuers of tax-exempt bonds in those transactions that are most closely comparable to the purchase of investments by the issuer of tax-exempt bonds. For example, reference to the bidding fees generally paid for the purchase of forward contracts for Treasury obligations is ordinarily a reasonable method of determining whether bidding fees are reasonable.

* * * * *

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 26, 1996, 8:45 a.m., and published in the issue of the Federal Register for June 27, 1996, 61 F.R. 33405)

Notice of Proposed Rulemaking and Notice of Public Hearing

Amortizable Bond Premium

FI–48–95

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the federal income tax treatment of bond premium and bond issuance premium. The proposed regulations reflect changes to the law made by the Tax Reform Act of 1986 and the Technical and Miscellaneous Revenue Act of 1988. The proposed regulations in this document would provide needed guidance to holders and issuers of debt instruments. This document also provides a notice of a public hearing on the proposed regulations.

DATES: Written comments must be received by September 25, 1996. Requests to appear and outlines of topics to be discussed at the public hearing scheduled for October 23, 1996, at 10 a.m. must be received by October 2, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (FI–48–95), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (FI–48–95), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. A public hearing will be held in the Commissioner's Conference Room, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, William P. Cejudo, (202) 622–4016, or Jeffrey W. Maddrey, (202) 622–3940; concerning submissions and the hearing, Christina Vasquez, (202) 622–7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507).

Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collections of information should be received by August 26, 1996.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collections of information are in proposed §§ 1.163–13(h)(3), 1.171–4(a)(1), and 1.171–5(c)(2)(iii). This information is required by the IRS to monitor compliance with the federal tax rules for amortizing bond premium and bond issuance premium. The likely respondents are taxpayers who either acquire a bond at a premium or issue a bond at a premium. Responses to this collection of information are required to determine whether a holder of a bond has elected to amortize bond premium and to determine whether an issuer or a holder has changed its method of accounting for premium.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Estimated total annual reporting burden: 50,000 hours. The estimated annual burden per respondent varies from 0.25 hours to 0.75 hours, depending on individual circumstances, with an estimated average of 0.5 hours.

Estimated number of respondents: 100,000.

Estimated annual frequency of responses: One time per respondent.

Background

Sections 1.171–1 through 1.171–4 of the Income Tax Regulations were promulgated in 1957 and last amended in 1968. In the Tax Reform Act of 1986, section 171(b) was amended to require that bond premium be amortized by reference to a constant yield. In the Technical and Miscellaneous Revenue Act of 1988, section 171(e) was amended to require that bond premium be amortized as an offset to interest income. The proposed regulations would substantially revise the existing regulations to reflect these amendments. In addition, the proposed regulations would revise existing guidance addressing the issuer's treatment of bond issuance premium.

Explanation of Provisions

In general, bond premium arises when a holder acquires a bond for more than the principal amount of the bond. Similarly, bond issuance premium arises when an issuer issues a bond for more than the principal amount of the bond. A holder will purchase, and an issuer will issue, a bond for more than its principal amount when the stated interest rate on the bond is higher than the current market yield for the bond.

The holder's treatment of bond premium is addressed in proposed regulations under section 171. The issuer's treatment of bond issuance premium is addressed in proposed regulations under section 163. In each case, the amortization of premium is based on constant yield principles. For this reason, the proposed regulations use concepts and definitions from the original issue discount (OID) regulations (§§ 1.1271–0 through 1.1275–6).

Determination of bond premium

Under the proposed regulations, bond premium is defined as the excess of a holder's basis in a bond over the sum of the remaining amounts payable on the bond other than payments of qualified stated interest. The holder generally determines the amount of bond premium as of the date the holder acquires the bond.

The proposed regulations provide special rules that limit a holder's basis solely for purposes of determining bond premium. For example, if a bond is convertible into stock of the issuer at the holder's option, for purposes of determining bond premium, the holder must reduce its basis in the bond by the value of the conversion option. This reduction prevents the holder from inappropriately amortizing the cost of the embedded conversion option.

Amortization of bond premium

Under section 171, the holder of a taxable bond acquired at a premium may elect to amortize bond premium. The holder of a tax-exempt bond acquired at a premium must amortize the premium. As premium is amortized, the holder's basis in the bond is reduced by a corresponding amount under section 1016(a)(5).

Under the proposed regulations, a holder amortizes bond premium by offsetting qualified stated interest income with bond premium. An offset is calculated for each accrual period using constant yield principles. However, the offset for an accrual period is only taken into account when the holder takes qualified stated interest into account under the holder's regular method of accounting. Thus, a holder using the cash receipts and disbursements method of accounting does not take bond premium into account until a qualified stated interest payment is received.

For certain bonds (e.g., bonds that pay a variable rate of interest or that provide for an interest holiday), the amount of bond premium allocable to an accrual period could exceed the amount of qualified stated interest allocable to that period. The proposed regulations address this situation by providing that the excess bond premium is not allowed as a deduction but is carried forward to future accrual periods.

Variable rate debt instruments

Because a variable rate debt instrument (VRDI) provides for variable interest payments, the yield and payment schedule of a VRDI cannot be determined without making assumptions about the amount of the variable payments. Under the OID regulations, OID on a VRDI is determined and allocated among accrual periods by reference to an equivalent fixed rate debt instrument constructed as of the issue date of the VRDI. The proposed regulations provide that bond premium on a VRDI is determined and allocated in a similar manner. Under the proposed regulations, bond premium on a VRDI is determined and allocated by reference to an equivalent fixed rate debt instrument. However, the equivalent fixed rate debt instrument is constructed as of the date the holder acquires the VRDI rather than the issue date.

Bonds subject to certain contingencies

If a bond provides for one or more alternative payment schedules, the yield of the bond cannot be determined without making assumptions about the actual payment schedule. The OID regulations provide three rules for making these assumptions. First, if one payment schedule is significantly more likely than not to occur, the yield of the debt instrument is determined by reference to this payment schedule. Second, if the debt instrument is subject to a mandatory sinking fund provision, the yield is determined without regard to the mandatory sinking fund provision. Third, notwithstanding the first two rules, if the debt instrument provides for an unconditional option or options to alter the payment schedule, the yield is determined by assuming that the issuer will exercise its options in the manner that minimizes the yield of the debt instrument and that the holder will exercise its options in the manner that maximizes the yield of the debt instrument.

The proposed regulations generally use similar assumptions to determine the holder's yield on a bond that provides for alternative payment schedules. However, in the case of an issuer's option on a taxable bond, the proposed regulations reverse the assumption by assuming that the issuer will exercise the option only if doing so would increase the yield on the bond. See section 171(b)(1)(B)(ii). As a result of this rule, a holder generally must amortize bond premium on a taxable bond by reference to the stated maturity date, even if it appears likely the bond will be called. In this case, if the bond is actually called, the proposed regulations provide that the holder may deduct the unamortized premium. If the bond is partially called and the partial call is not a pro-rata prepayment, the proposed regulations do not allow the holder to deduct a portion of the unamortized premium. Instead, the holder must recompute the yield of the bond on the date of the partial call and amortize the remaining premium by reference to the recomputed yield.

Treasury and IRS request comments on the application of the alternative payment schedule rules. Specifically, comments are requested on whether the ''significantly more likely than not to occur'' standard is appropriate for taxable bonds, whether ignoring mandatory sinking fund provisions is appropriate for tax-exempt bonds, and whether the distinction between pro-rata and non-pro-rata calls is appropriate.

Bond issuance premium

Under existing § 1.61–12(c), a corporate issuer treats premium received upon issuance of a bond as a separate item of income. Over the term of the bond, the premium is taken into income, and the full amount of the stated interest is deducted. The proposed regulations would revise the treatment of bond issuance premium. Under the proposed regulations, bond issuance premium is amortized as an offset to the issuer's otherwise allowable interest deduction, not as a separate item of income. The amount of bond issuance premium amortized in any period is based on a constant yield. In addition, the proposed regulations would apply to all issuers, not just corporate issuers.

De minimis rules and aggregate rules

The proposed regulations do not provide rules for *de minimis* amounts of premium or for aggregate methods of accounting for premium. Treasury and IRS request comments on whether de minimis rules or aggregate rules are necessary or appropriate.

Bonds not subject to the proposed regulations

The proposed regulations generally apply to bonds acquired or issued at a premium. Certain bonds, however, are excluded from the application of the proposed regulations. For example, the proposed regulations exclude debt instruments subject to section 1272(a)(6) (relating to certain prepayable debt in-

struments). No inference is intended regarding the treatment of these debt instruments.

Proposed effective dates

The proposed regulations relating to bond premium provide that the final regulations generally will apply to bonds acquired on or after the date 60 days after the date final regulations are published in the **Federal Register**. However, if a holder makes the election to amortize bond premium for the taxable year containing the date 60 days after the date final regulations are published, the regulations apply to bonds held on or after the first day of that taxable year.

The proposed regulations relating to bond issuance premium provide that the final regulations will apply to debt instruments issued on or after the date 60 days after the date final regulations are published in the **Federal Register.**

The proposed regulations also would provide automatic consent for a taxpayer to change its method of accounting for premium in certain circumstances. Because the change is made on a cut-off basis, no items of income or deduction are omitted or duplicated. Therefore, no adjustment under section 481 is allowed.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for October 23, 1996, at 10 a.m. in the Commissioner's Conference Room, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by September 25, 1996, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by October 2, 1996.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are William P. Cejudo and Jeffrey W. Maddrey of the Office of Assistant Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.171–2 also issued under 26 U.S.C. 171(e).

Section 1.171–3 also issued under 26 U.S.C. 171(e).

Section 1.171–4 also issued under 26 U.S.C. 171(c). * * *

Par. 2. Section 1.61–12 is amended by revising paragraph (c) to read as follows:

§ 1.61–12 Income from discharge of indebtedness.

* * * * *

(c) *Issuance and repurchase of debt instruments*—(1) *Issuance.* An issuer does not realize gain or loss upon the issuance of a debt instrument (as defined in § 1.1275–1(d)).

(2) *Repurchase*—(i) *In general.* An issuer does not realize gain or loss upon the repurchase of a debt instrument. For purposes of this paragraph (c)(2), the term *repurchase* includes the retirement of a debt instrument, the conversion of a debt instrument into stock of the issuer, and the exchange (including an exchange under section 1001) of a newly issued debt instrument for an existing debt instrument.

(ii) *Repurchase at a discount.* An issuer realizes income from the discharge of indebtedness upon the repurchase of a debt instrument for an amount less than its adjusted issue price (as defined in § 1.163–13(d)(5)). The amount of discharge of indebtedness income is equal to the excess of the adjusted issue price over the repurchase price. To determine the repurchase price of a debt instrument that is repurchased through the issuance of a new debt instrument, see section 108(e)(10). See § 1.108–2 for rules relating to the realization of discharge of indebtedness income upon the acquisition of a debt instrument by a person related to the issuer.

(iii) *Repurchase at a premium.* An issuer may be entitled to a repurchase premium deduction upon the repurchase of a debt instrument for an amount greater than its adjusted issue price (as defined in § 1.163–13(d)(5)). See § 1.163–7(c) for the treatment of repurchase premium.

(3) *Bond issuance premium.* For rules relating to an issuer's interest deduction for a debt instrument issued with bond issuance premium, see § 1.163–13.

(4) *Effective date.* This paragraph (c) applies to debt instruments issued on or after the date that is 60 days after the date final regulations are published in the **Federal Register.**

* * * * *

Par. 3. Section 1.163–7 is amended by revising the first sentence of paragraph (c) to read as follows:

§ 1.163–7 Deduction for OID on certain debt instruments.

* * * * *

(c) *Deduction upon repurchase.* Except to the extent disallowed by any other section of the Internal Revenue Code (e.g., section 249) or this paragraph (c), if a debt instrument is repurchased by the issuer for a price in excess of its adjusted issue price (as defined in § 1.163–13(d)(5)), the excess (repurchase premium) is deductible as

interest for the taxable year in which the repurchase occurs. * * *

* * * * *

Par. 4. Section 1.163–13 is added to read as follows:

§ 1.163–13 Treatment of bond issuance premium.

(a) *General rule.* If a debt instrument is issued with bond issuance premium, this section limits the amount of the issuer's interest deduction otherwise allowable under section 163(a). In general, the issuer determines its interest deduction by offsetting the interest allocable to an accrual period with the bond issuance premium allocable to that period. Bond issuance premium is allocable to an accrual period based on a constant yield. The use of a constant yield to amortize bond issuance premium is intended to conform the treatment of debt instruments having bond issuance premium with those having original issue discount. Unless otherwise provided, the terms used in this section have the same meaning as those terms in section 163(e), sections 1271 through 1275, and the corresponding regulations. Moreover, the provisions of this section apply in a manner consistent with those of section 163(e), sections 1271 through 1275, and the corresponding regulations. In addition, the anti- abuse rule in § 1.1275–2(g) applies for purposes of this section. For rules dealing with the treatment of bond premium by a holder, see §§ 1.171–1 through 1.171–5.

(b) *Exceptions.* This section does not apply to—

(1) A debt instrument to which section 1272(a)(6) applies (relating to certain interests in or mortgages held by a REMIC, and certain other debt instruments with payments subject to acceleration); or

(2) A debt instrument to which § 1.1275–4 applies (relating to certain debt instruments that provide for contingent payments).

(c) *Bond issuance premium.* Bond issuance premium is the excess, if any, of the issue price of a debt instrument over its stated redemption price at maturity. For purposes of this section, the issue price of a convertible bond (as defined in § 1.171–1(e)(1)(iii)(C)) does not include an amount equal to the value of the conversion option.

(d) *Offsetting qualified stated interest with bond issuance premium*—(1) *In general.* An issuer amortizes bond issuance premium by offsetting the qualified stated interest allocable to an accrual period with the bond issuance premium allocable to the accrual period. This offset occurs when the issuer takes the qualified stated interest into account under its regular method of accounting.

(2) *Qualified stated interest allocable to an accrual period.* See § 1.446–2(b) to determine the accrual period to which qualified stated interest is allocable and to determine the accrual of qualified stated interest within an accrual period.

(3) *Bond issuance premium allocable to an accrual period.* The bond issuance premium allocable to an accrual period is determined under this paragraph (d)(3). Within an accrual period, the bond issuance premium allocable to the period accrues ratably.

(i) *Step one: Determine the debt instrument's yield to maturity.* The yield to maturity of a debt instrument is determined under the rules of § 1.1272–1(b)(1)(i).

(ii) *Step two: Determine the accrual periods.* The accrual periods are determined under the rules of § 1.1272–1(b)(1)(ii).

(iii) *Step three: Determine the bond issuance premium allocable to the accrual period.* The bond issuance premium allocable to an accrual period is the excess of the qualified stated interest allocable to the accrual period over the product of the adjusted issue price at the beginning of the accrual period and the yield. In performing this calculation, the yield must be stated appropriately taking into account the length of the particular accrual period. Principles similar to those in § 1.1272–1(b)(4) apply in determining the bond issuance premium allocable to an accrual period.

(4) *Bond issuance premium in excess of qualified stated interest.* If the bond issuance premium allocable to an accrual period exceeds the qualified stated interest allocable to the accrual period for a debt instrument, the excess is carried forward to the next accrual period and offsets qualified stated interest in that accrual period to the extent of the disallowed amount. If the amount carried forward to an accrual period exceeds the qualified stated interest for that period, the excess is carried forward to subsequent accrual periods, beginning with the next accrual period, and is used to offset qualified stated interest in those accrual periods to the extent of the excess. If an excess amount exists on the date the debt instrument is retired, the issuer takes this amount into account as ordinary income.

(5) *Adjusted issue price.* In general, the adjusted issue price of a debt instrument is determined under the rules of § 1.1275–1(b). In addition, the adjusted issue price of the debt instrument is decreased by the amount of bond issuance premium previously allocable under paragraph (d)(3) of this section.

(e) *Special rules*—(1) *Variable rate debt instruments issued with bond issuance premium.* Bond issuance premium on a variable rate debt instrument is determined by reference to the stated redemption price at maturity of the equivalent fixed rate debt instrument constructed as of the issue date. In addition, the issuer allocates bond issuance premium on a variable rate debt instrument among the accrual periods by reference to the equivalent fixed rate debt instrument. The equivalent fixed rate debt instrument is determined using the principles of § 1.1275–5(e).

(2) *Remote and incidental contingencies.* For purposes of determining and amortizing bond issuance premium, if a bond provides for a contingency that is remote or incidental (within the meaning of § 1.1275–2(h)), the contingency is taken into account under the rules for remote and incidental contingencies in § 1.1275–2(h).

(f) *Example.* The following example illustrates the rules of this section.

Example—(i) *Facts.* On February 1, 1999, X issues for $110,000 a debt instrument maturing on February 1, 2006, with a stated principal amount of $100,000, payable at maturity. The debt instrument provides for unconditional payments of interest of $10,000, payable on February 1 of each year. X uses the calendar year as its taxable year, X uses the cash receipts and disbursements method of accounting, and X decides to use annual accrual periods ending on February 1 of each year. X's calculations assume a 30-day month and 360-day year.

(ii) *Amount of bond issuance premium.* The issue price of the debt instrument is $110,000. Because the interest payments on the debt instrument are qualified stated interest, the stated redemption price at maturity of the debt instrument is $100,000. Therefore, the amount of bond issuance premium is $10,000 ($110,000 – $100,000).

(iii) *Bond issuance premium allocable to the first accrual period.* Based on the payment schedule and the issue price of the debt instrument, the yield of the debt instrument is 8.07 percent, compounded annually. (Although, for purposes of simplicity, the yield as stated is rounded to two decimal places, the computations do not reflect this rounding convention.) The bond issuance premium allocable to the accrual period ending on February 1, 2000, is the excess of the qualified stated interest allocable to the period ($10,000) over the product of the adjusted issue price at the beginning of the period ($110,000) and the yield (8.07 percent, compounded annually). Therefore, the bond issuance premium allocable to the accrual period is $1,118.17 ($10,000 – $8,881.83).

(iv) *Premium used to offset interest.* Although X makes an interest payment of $10,000 on February 1, 2000, X only deducts interest of $8,881.83, the qualified stated interest allocable to the period ($10,000) offset with bond issuance premium allocable to the period ($1,118.17).

(g) *Effective date.* This section applies to debt instruments issued on or after the date that is 60 days after the date final regulations are published in the **Federal Register.**

(h) *Consent to change method of accounting.* The Commissioner grants consent for an issuer to change its method of accounting for bond issuance premium on debt instruments issued on or after the date that is 60 days after the date final regulations are published in the **Federal Register. However, this consent is granted only if—**

(1) The change is made to comply with this section;

(2) The change is made for the first taxable year for which the issuer must account for a debt instrument under this section; and

(3) The issuer attaches to its federal income tax return for the taxable year containing the change a statement that it has changed its method of accounting under this section.

Par. 5. Sections 1.171–1 through 1.171–4 are revised to read as follows:

§ 1.171–1 Bond premium.

(a) *Overview*—(1) *In general.* This section and §§ 1.171–2 through 1.171–5 provide rules for the determination and amortization of bond premium by a holder. In general, a holder amortizes bond premium by offsetting the interest allocable to an accrual period with the premium allocable to that period. Bond premium is allocable to an accrual period based on a constant yield. The use of a constant yield to amortize bond premium is intended generally to conform the treatment of bond premium to the treatment of original issue discount under sections 1271 through 1275. Unless otherwise provided, the terms used in this section and §§ 1.171–2 through 1.171–5 have the same meaning as those terms in sections 1271 through 1275 and the corresponding regulations. Moreover, the provisions of this section and §§ 1.171–2 through 1.171–5 apply in a manner consistent with those of sections 1271 through 1275 and the corresponding regulations. In addition, the anti-abuse rule in § 1.1275–2(g) applies for purposes of this section and §§ 1.171–2 through 1.171–5.

(2) *Cross-references.* For rules dealing with the adjustments to a holder's basis to reflect the amortization of bond premium, see § 1.1016–5(b). For rules dealing with the treatment of bond issuance premium by an issuer, see § 1.163–13.

(b) *Scope*—(1) *In general.* Except as provided in paragraph (b)(2) of this section, this section and §§ 1.171–2 through 1.171–5 apply to any bond that, upon its acquisition by the holder, is held with bond premium. For purposes of this section and §§ 1.171–2 through 1.171–5, the term *bond* has the same meaning as the term *debt instrument* in § 1.1275–1(d).

(2) *Exceptions.* This section and §§ 1.171–2 through 1.171–5 do not apply to—

(i) A bond to which section 1272(a)(6) applies (relating to certain interests in or mortgages held by a REMIC, and certain other debt instruments with payments subject to acceleration);

(ii) A bond to which § 1.1275–4 applies (relating to certain debt instruments that provide for contingent payments);

(iii) A bond held by a holder that has made a § 1.1272–3 election with respect to the bond;

(iv) A bond that is stock in trade of the holder, a bond of a kind that would properly be included in the inventory of the holder if on hand at the close of the taxable year, or a bond held primarily for sale to customers in the ordinary course of the holder's trade or business; or

(v) A bond issued before September 28, 1985, unless the bond bears interest and was issued by a corporation or by a government or political subdivision thereof.

(c) *General rule*—(1) *Tax-exempt obligations.* A holder must amortize bond premium on a bond that is a tax-exempt obligation. See § 1.171–2(c) *Example 4.*

(2) *Taxable bonds.* A holder may elect to amortize bond premium on a taxable bond. Except as provided in paragraph (c)(3) of this section, a taxable bond is any bond other than a tax-exempt obligation. See § 1.171–4 for rules relating to the election to amortize bond premium on a taxable bond.

(3) *Bonds the interest on which is partially excludable.* For purposes of this section and §§ 1.171–2 through 1.171–5, a bond the interest on which is partially excludable from gross income (e.g., a securities acquisition loan under section 133) is treated as two instruments, a tax-exempt obligation and a taxable bond. The holder's basis in the bond and each payment on the bond are allocated between the two instruments based on the ratio of the interest excludable to the total interest payable on the bond.

(d) *Determination of bond premium*—(1) *In general.* A holder acquires a bond at a premium if the holder's basis in the bond immediately after its acquisition by the holder exceeds the sum of all amounts payable on the bond after the acquisition date (other than payments of qualified stated interest). This excess is bond premium, which is amortizable under § 1.171–2.

(2) *Additional rules for amounts payable on certain bonds.* Additional rules apply to determine the amounts payable on a variable rate debt instrument and on a bond that provides for certain alternative payment schedules. See § 1.171–3.

(e) *Basis.* A holder determines its basis in a bond under this paragraph (e). This determination of basis applies only for purposes of this section and §§ 1.171–2 through 1.171–5. Because of the application of this paragraph (e), the holder's basis in the bond for purposes of these sections may differ from the holder's basis for determining gain or loss on the sale or exchange of the bond.

(1) *Determination of basis*—(i) *In general.* In general, the holder's basis in the bond is the holder's basis for determining loss on the sale or exchange of the bond.

(ii) *Bonds acquired in certain exchanges.* If the holder acquired the bond in exchange for other property (other than in a reorganization defined in section 368) and the holder's basis in the bond is determined in whole or in part by reference to the holder's basis in the other property, the holder's basis in the bond may not exceed its fair market value immediately after the exchange. See paragraph (f) *Example 1* of this section. If the bond is acquired in a reorganization, see section 171(b)(4)(B).

(iii) *Convertible bonds*—(A) *General rule.* If the bond is a convertible bond, the holder's basis in the bond is reduced by an amount equal to the value of the conversion option. The value of the conversion option may be determined under any reasonable method. For example, the holder may determine the value of the conversion option by comparing the market price of the convertible bond to the market prices of similar

bonds that do not have conversion options. See paragraph (f) *Example 2* of this section.

(B) *Convertible bonds acquired in certain exchanges.* If the bond is a convertible bond acquired in a transaction described in paragraph (e)(1)(ii) of this section, the holder's basis in the bond may not exceed its fair market value immediately after the exchange reduced by the value of the conversion option.

(C) *Definition of convertible bond.* A convertible bond is a bond that provides the holder with an option to convert the bond into stock of the issuer, stock or debt of a related party (within the meaning of section 267(b) or 707(b)(1)), or into cash or other property in an amount equal to the approximate value of that stock or debt.

(2) *Basis in bonds held by certain transferees.* Notwithstanding paragraph (e)(1) of this section, if the bond is transferred basis property (as defined in section 7701(a)(43)) and the transferor had acquired the bond at a premium, the holder's basis in the bond is—

(i) The holder's basis for determining loss on the sale or exchange of the bond; reduced by

(ii) Any amounts that the transferor could not have amortized under this paragraph (e) or under § 1.171–4(c).

(f) *Examples.* The following examples illustrate the rules of this section.

Example 1. Bond received in liquidation of a partnership interest—(i) *Facts.* PR is a partner in partnership PRS. PRS does not have any unrealized receivables or substantially appreciated inventory items as defined in section 751. On January 1, 1997, PRS distributes to PR a taxable bond, issued by an unrelated corporation, in liquidation of PR's partnership interest. At that time, the fair market value of PR's partnership interest is $40,000 and the basis is $100,000. The fair market value of the bond is $40,000.

(ii) *Determination of basis.* Under section 732(b), PR's basis in the bond is equal to PR's basis in the partnership interest. Therefore, PR's basis for determining loss on the sale or exchange of the bond is $100,000. However, under paragraph (e)(1)(ii) of this section, PR's basis in the bond is $40,000 for purposes of this section and §§ 1.171–2 through 1.171–5.

Example 2. Convertible bond—(i) *Facts.* On January 1, 1997, A purchases for $1,100 B corporation's bond maturing on January 1, 2000, with a stated principal amount of $1,000, payable at maturity. The bond provides for unconditional payments of interest of $30 on January 1 and July 1 of each year. In addition, the bond is convertible into 15 shares of B corporation stock at the option of the holder. On January 1, 1997, B corporation's nonconvertible, publicly-traded, three-year debt with similar credit rating trades at a price that reflects a yield of 6.75 percent, compounded semiannually.

(ii) *Determination of basis.* A's basis for determining loss on the sale or exchange of the bond is $1,100. As of January 1, 1997, discounting the remaining payments on the bond at the yield at which B's similar nonconvertible bonds trade (6.75 percent, compounded semiannually) results in a present value of $980. Thus, the value of the conversion option is $120. Under paragraph (e)(1)(iii)(A) of this section, A's basis is $980 ($1,100 – $120) for purposes of this section and §§ 1.171–2 through 1.171–5. The sum of all amounts payable on the bond other than qualified stated interest is $1,000. Because A's basis (as determined under paragraph (e)(1)(iii)(A) of this section) does not exceed $1,000, A does not acquire the bond at a premium.

§ 1.171–2 Amortization of bond premium.

(a) *Offsetting qualified stated interest with premium*—(1) *In general.* A holder amortizes bond premium by offsetting the qualified stated interest allocable to an accrual period with the bond premium allocable to the accrual period. This offset occurs when the holder takes the qualified stated interest into account under the holder's regular method of accounting.

(2) *Qualified stated interest allocable to an accrual period.* See § 1.446–2(b) to determine the accrual period to which qualified stated interest is allocable and to determine the accrual of qualified stated interest within an accrual period.

(3) *Bond premium allocable to an accrual period.* The bond premium allocable to an accrual period is determined under this paragraph (a)(3). Within an accrual period, the bond premium allocable to the period accrues ratably.

(i) *Step one: Determine the holder's yield.* The holder's yield is the discount rate that, when used in computing the present value of all remaining payments to be made on the bond (including payments of qualified stated interest), produces an amount equal to the holder's basis in the bond as determined under § 1.171–1(e). For this purpose, the remaining payments include only payments to be made after the date the holder acquires the bond. The yield is calculated as of the date the holder acquires the bond, must be constant over the term of the bond, and must be calculated to at least two decimal places when expressed as a percentage.

(ii) *Step two: Determine the accrual periods.* A holder determines the accrual periods for the bond under the rules of § 1.1272–1(b)(1)(ii).

(iii) *Step three: Determine the bond premium allocable to the accrual period.* The bond premium allocable to an accrual period is the excess of the qualified stated interest allocable to the accrual period over the product of the holder's adjusted acquisition price (as defined in paragraph (b) of this section) at the beginning of the accrual period and the holder's yield. In performing this calculation, the yield must be stated appropriately taking into account the length of the particular accrual period. Principles similar to those in § 1.1272–1(b)(4) apply in determining the bond premium allocable to an accrual period.

(4) *Bond premium in excess of qualified stated interest.* If the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to the accrual period for that bond, the excess is carried forward to the next accrual period and offsets qualified stated interest in that accrual period to the extent of the disallowed amount. If the bond premium carried forward to an accrual period exceeds the qualified stated interest for that period, the excess is carried forward to subsequent accrual periods, beginning with the next accrual period, and is used to offset qualified stated interest in those accrual periods to the extent of the excess.

(5) *Additional rules for certain bonds.* Additional rules apply to determine the amortization of bond premium on a variable rate debt instrument and on a bond that provides for certain alternative payment schedules. See § 1.171–3.

(b) *Adjusted acquisition price.* The adjusted acquisition price of a bond at the beginning of the first accrual period is the holder's basis as determined under § 1.171–1(e). Thereafter, the adjusted acquisition price is the holder's basis in the bond decreased by—

(1) The amount of bond premium previously allocable under paragraph (a)(3) of this section; and

(2) The amount of any payment previously made on the bond other than a payment of qualified stated interest.

(c) *Examples.* The following examples illustrate the rules of this section. Each example assumes the holder uses the calendar year as its taxable year and has elected to amortize bond premium, effective for all relevant taxable years. In addition, each example assumes a 30-day month and 360-day year. Although, for purposes of simplicity, the yield as stated is rounded to two decimal places, the computations do not reflect this rounding convention.

Example 1. Taxable bond—(i) *Facts.* On February 1, 1999, A purchases for $110,000 a taxable bond maturing on February 1, 2006, with a stated principal amount of $100,000, payable at maturity. The bond provides for unconditional payments of interest of $10,000, payable on February 1 of each

year. A uses the cash receipts and disbursements method of accounting, and A decides to use annual accrual periods ending on February 1 of each year.

(ii) *Amount of bond premium.* The interest payments on the bond are qualified stated interest. Therefore, the sum of all amounts payable on the bond (other than the interest payments) is $100,000. Under § 1.171–1, the amount of bond premium is $10,000 ($110,000 – $100,000).

(iii) *Bond premium allocable to the first accrual period.* Based on the remaining payment schedule of the bond and A's basis in the bond, A's yield is 8.07 percent, compounded annually. The bond premium allocable to the accrual period ending on February 1, 2000, is the excess of the qualified stated interest allocable to the period ($10,000) over the product of the adjusted acquisition price at the beginning of the period ($110,000) and A's yield (8.07 percent, compounded annually). Therefore, the bond premium allocable to the accrual period is $1,118.17 ($10,000 – $8,881.83).

(iv) *Premium used to offset interest.* Although A receives an interest payment of $10,000 on February 1, 2000, A only includes in income $8,881.83, the qualified stated interest allocable to the period ($10,000) offset with bond premium allocable to the period ($1,118.17). Under § 1.1016–5(b), A's basis in the bond is reduced by $1,118.17 on February 1, 2000.

Example 2. Alternative accrual periods—(i) *Facts.* The facts are the same as in *Example 1* of this paragraph (c) except that A decides to use semiannual accrual periods ending on February 1 and August 1 of each year.

(ii) *Bond premium allocable to the first accrual period.* Based on the remaining payment schedule of the bond and A's basis in the bond, A's yield is 7.92 percent, compounded semiannually. The bond premium allocable to the accrual period ending on August 1, 1999, is the excess of the qualified stated interest allocable to the period ($5,000) over the product of the adjusted acquisition price at the beginning of the period ($110,000) and A's yield, stated appropriately taking into account the length of the accrual period (7.92 percent/2). Therefore, the bond premium allocable to the accrual period is $645.29 ($5,000 – $4,354.71). Although the accrual period ends on August 1, 1999, the qualified stated interest of $5,000 is not taken into income until February 1, 2000, the date it is received. Likewise, the bond premium of $645.29 is not taken into account until February 1, 2000. The adjusted acquisition price of the bond on August 1, 1999, is $109,354.71 (the adjusted acquisition price at the beginning of the period ($110,000) less the bond premium allocable to the period ($645.29)).

(iii) *Bond premium allocable to the second accrual period.* Because the interval between payments of qualified stated interest contains more than one accrual period, the adjusted acquisition price at the beginning of the second accrual period must be adjusted for the accrued but unpaid qualified stated interest. Therefore, the adjusted acquisition price on August 1, 1999, is $114,354.71 ($109,354.71 + $5,000). The bond premium allocable to the accrual period ending on February 1, 2000, is the excess of the qualified stated interest allocable to the period ($5,000) over the product of the adjusted acquisition price at the beginning of the period ($114,354.71) and A's yield, stated appropriately taking into account the length of the accrual period (7.92 percent/2). Therefore, the bond premium allocable to the accrual period is $472.88 ($5,000 – $4,527.12).

(iv) *Premium used to offset interest.* Although A receives an interest payment of $10,000 on February 1, 2000, A only includes in income $8,881.83, the qualified stated interest of $10,000 ($5,000 allocable to the accrual period ending on August 1, 1999, and $5,000 allocable to the accrual period ending on February 1, 2000) offset with bond premium of $1,118.17 ($645.29 allocable to the accrual period ending on August 1, 1999, and $472.88 allocable to the accrual period ending on February 1, 2000). As indicated in *Example 1* of this paragraph (c), this same amount would be taken into income at the same time had A used annual accrual periods.

Example 3. Holder uses accrual method of accounting—(i) *Facts.* The facts are the same as in *Example 1* of this paragraph (c) except that A uses the accrual method of accounting. Thus, for the accrual period ending on February 1, 2000, the qualified stated interest allocable to the period is $10,000, and the bond premium allocable to the period is $1,118.17. Because the accrual period extends beyond the end of A's taxable year, A must allocate these amounts between the two taxable years.

(ii) *Amounts allocable to the first taxable year.* The qualified stated interest allocable to the first taxable year is $9,166.67 ($10,000 x 11/12). The bond premium allocable to the first taxable year is $1,024.99 ($1,118.17 x 11/12).

(iii) *Premium used to offset interest.* For 1999, A includes in income $8,141.68, the qualified stated interest allocable to the period ($9,166.67) offset with bond premium allocable to the period ($1,024.99). Under § 1.1016–5(b), A's basis in the bond is reduced by $1,024.99 in 1999.

(iv) *Amounts allocable to the next taxable year.* The remaining amounts of qualified stated interest and bond premium allocable to the accrual period ending on February 1, 2000, are taken into account for the taxable year ending on December 31, 2000.

Example 4. Tax-exempt obligation—(i) *Facts.* On January 15, 1999, C purchases for $120,000 a tax-exempt obligation maturing on January 15, 2006, with a stated principal amount of $100,000, payable at maturity. The obligation provides for unconditional payments of interest of $9,000, payable on January 15 of each year. C uses the cash receipts and disbursements method of accounting, and C decides to use annual accrual periods ending on January 15 of each year.

(ii) *Amount of bond premium.* The interest payments on the obligation are qualified stated interest. Therefore, the sum of all amounts payable on the obligation (other than the interest payments) is $100,000. Under § 1.171–1, the amount of bond premium is $20,000 ($120,000 – $100,000).

(iii) *Bond premium allocable to the first accrual period.* Based on the remaining payment schedule of the obligation and C's basis in the obligation, C's yield is 5.48 percent, compounded annually. The bond premium allocable to the accrual period ending on January 15, 2000, is the excess of the qualified stated interest allocable to the period ($9,000) over the product of the adjusted acquisition price at the beginning of the period ($120,000) and C's yield (5.48 percent, compounded annually). Therefore, the bond premium allocable to the accrual period is $2,420.55 ($9,000 – $6,579.45).

(iv) *Premium used to offset interest.* Although C receives an interest payment of $9,000 on January 15, 2000, C only receives tax-exempt interest income of $6,579.45, the qualified stated interest allocable to the period ($9,000) offset with bond premium allocable to the period ($2,420.55). Under § 1.1016–5(b), C's basis in the obligation is reduced by $2,420.55 on January 15, 2000.

§ 1.171–3 Special rules for certain bonds.

(a) *Variable rate debt instruments.* Bond premium on a variable rate debt instrument is determined by reference to the stated redemption price at maturity of the equivalent fixed rate debt instrument constructed for the variable rate debt instrument. In addition, a holder allocates bond premium on a variable rate debt instrument among the accrual periods by reference to the equivalent fixed rate debt instrument. The equivalent fixed rate debt instrument is determined as of the date the variable rate debt instrument is acquired by the holder and is constructed using the principles of § 1.1275–5(e). See paragraph (d) *Example 1* of this section.

(b) *Yield and remaining payment schedule of certain bonds subject to contingencies*—(1) *Applicability.* This paragraph (b) provides rules that apply in determining the yield and remaining payment schedule of certain bonds that provide for an alternative payment schedule (or schedules) applicable upon the occurrence of a contingency (or contingencies). This paragraph (b) applies, however, only if the timing and amounts of the payments that comprise each payment schedule are known as of the date the holder acquires the bond (the *acquisition date*) and the bond is subject to paragraph (b)(2), (3), or (4) of this section. A bond does not provide for an alternative payment schedule merely because there is a possibility of impairment of a payment (or payments) by insolvency, default, or similar circumstances. See § 1.1275–4 for the treatment of a bond that provides for a contingency that is not described in this paragraph (b).

(2) *Remaining payment schedule that is significantly more likely than not to occur.* If, based on all the facts and circumstances as of the acquisition date, a single remaining payment schedule for a bond is significantly more likely than not to occur, this remaining payment schedule is used to determine and amortize bond premium under §§ 1.171–1 and 1.171–2.

(3) *Mandatory sinking fund provision.* Notwithstanding paragraph (b)(2) of this section, if a bond is subject to a mandatory sinking fund provision described in § 1.1272–1(c)(3) and the use and terms of the provision meet reasonable commercial standards, the provision is ignored for purposes of determining and

amortizing bond premium under §§ 1.171–1 and 1.171–2.

(4) *Treatment of certain options*—(i) *Applicability.* Notwithstanding paragraphs (b)(2) and (3) of this section, the rules of this paragraph (b)(4) determine the remaining payment schedule of a bond that provides the holder or issuer with an unconditional option or options, exercisable on one or more dates during the remaining term of the bond, to alter the bond's remaining payment schedule.

(ii) *Operating rules.* A holder determines the remaining payment schedule of a bond by assuming that each option will (or will not) be exercised under the following rules:

(A) *Issuer options.* The issuer of a tax-exempt obligation is deemed to exercise or not exercise an option or combination of options in the manner that minimizes the holder's yield on the obligation. The issuer of a taxable bond is deemed to exercise or not exercise an option or combination of options in the manner that maximizes the holder's yield on the bond.

(B) *Holder options.* A holder is deemed to exercise or not exercise an option or combination of options in the manner that maximizes the holder's yield on the bond.

(C) *Multiple options.* If both the issuer and the holder have options, the rules of paragraphs (b)(4)(ii)(A) and (B) of this section are applied to the options in the order that they may be exercised. Thus, the deemed exercise of one option may eliminate other options that are later in time.

(5) *Subsequent adjustments*—(i) *In general.* Except as provided in paragraph (b)(5)(ii) of this section, if a contingency described in this paragraph (b) (including the exercise of an option described in paragraph (b)(4) of this section) actually occurs or does not occur, contrary to the assumption made pursuant to this paragraph (b) (a *change in circumstances*), then solely for purposes of section 171, the bond is treated as retired and reacquired by the holder on the date of the change in circumstances for an amount equal to the adjusted acquisition price of the bond as of that date. If, however, the change in circumstances results in a substantially contemporaneous pro-rata prepayment as defined in § 1.1275–2(f)(2), the pro-rata prepayment is treated as a payment in retirement of a portion of the bond. See paragraph (d) *Example 2* of this section.

(ii) *Bond premium deduction on the issuer's call of a taxable bond.* If a change in circumstances results from an issuer's call of a taxable bond or a partial call that is a pro- rata prepayment, the holder may deduct as bond premium an amount equal to the excess, if any, of the adjusted acquisition price of the bond over the greater of the amount received on redemption or the amount payable on maturity.

(c) *Remote and incidental contingencies.* For purposes of determining and amortizing bond premium, if a bond provides for a contingency that is remote or incidental (within the meaning of § 1.1275–2(h)), the contingency is taken into account under the rules for remote and incidental contingencies in § 1.1275–2(h).

(d) *Examples.* The following examples illustrate the rules of this section. Each example assumes the holder uses the calendar year as its taxable year and, except as otherwise stated, has elected to amortize bond premium, effective for all relevant taxable years. In addition, each example assumes a 30-day month and 360-day year. Although, for purposes of simplicity, the yield as stated is rounded to two decimal places, the computations do not reflect this rounding convention.

Example 1. Variable rate debt instrument—(i) *Facts.* On March 1, 1999, E purchases for $110,000 a taxable bond maturing on March 1, 2007, with a stated principal amount of $100,000, payable at maturity. The bond provides for unconditional payments of interest on March 1 of each year based on the percentage appreciation of a nationally-known commodity index. On March 1, 1999, it is reasonably expected that the bond will yield 12 percent, compounded annually. E uses the cash receipts and disbursements method of accounting, and E decides to use annual accrual periods ending on March 1 of each year. Assume that the bond is a variable rate debt instrument under § 1.1275–5.

(ii) *Amount of bond premium.* Because the bond is a variable rate debt instrument, E determines and amortizes its bond premium by reference to the equivalent fixed rate debt instrument constructed for the bond as of March 1, 1999. Because the bond provides for interest at a single objective rate that is reasonably expected to yield 12 percent, compounded annually, the equivalent fixed rate debt instrument for the bond is an eight-year bond with a principal amount of $100,000, payable at maturity. It provides for annual payments of interest of $12,000. E's basis in the equivalent fixed rate debt instrument is $110,000. The sum of all amounts payable on the equivalent fixed rate debt instrument (other than payments of qualified stated interest) is $100,000. Under § 1.171–1, the amount of bond premium is $10,000 ($110,000 – $100,000).

(iii) *Bond premium allocable to each accrual period.* E allocates bond premium to the remaining accrual periods by reference to the payment schedule on the equivalent fixed rate debt instrument. Based on the payment schedule of the equivalent fixed rate debt instrument and E's basis in the bond, E's yield is 10.12 percent, compounded annually. The bond premium allocable to the accrual period ending on March 1, 2000, is the excess of the qualified stated interest allocable to the period for the equivalent fixed rate debt instrument ($12,000) over the product of the adjusted acquisition price at the beginning of the period ($110,000) and E's yield (10.12 percent, compounded annually). Therefore, the bond premium allocable to the accrual period is $870.71 ($12,000 – $11,129.29). The bond premium allocable to all the accrual periods is listed in the following schedule:

Accrual period ending	*Adjusted acquisition price at beginning of accrual period*	*Premium allocable to accrual period*
3/1/00	$110,000.00	$870.71
3/1/01	109,129.29	958.81
3/1/02	108,170.48	1,055.82
3/1/03	107,114.66	1,162.64
3/1/04	105,952.02	1,280.27
3/1/05	104,671.75	1,409.80
3/1/06	103,261.95	1,552.44
3/1/07	101,709.51	1,709.51
		$10,000.00

(iv) *Qualified stated interest for each accrual period.* Assume the bond actually pays the following amounts of qualified stated interest:

Accrual period ending	*Qualified stated interest*
3/1/00	$15,000.00
3/1/01	0.00
3/1/02	0.00
3/1/03	10,000.00
3/1/04	8,000.00
3/1/05	12,000.00
3/1/06	15,000.00
3/1/07	8,500.00

(v) *Premium used to offset interest.* E's interest income for each accrual period is determined by offsetting the qualified stated interest allocable to the period with the bond premium allocable to the period. For the accrual period ending on March 1, 2000, E includes in income $14,129.29, the qualified stated interest allocable to the period ($15,000) offset with the bond premium allocable to the period ($870.71). For the accrual period ending on March 1, 2001, the bond premium allocable to the period ($958.81) exceeds the qualified stated interest allocable to the period ($0). Therefore, the excess of $958.81 ($958.81 – $0) is carried forward to the next accrual period. For the next accrual period, the qualified stated interest for the period is insufficient to offset the bond premium allocable to the period ($1,055.82) and the amount carried forward from the prior period ($958.81). Thus, $2,014.63 ($1,055.82 + $958.81) is carried forward to the accrual period ending on March 1, 2003, and offsets qualified stated interest allocable to that period. The amount E includes in income for each accrual period is shown in the following schedule:

Accrual period ending	*Qualified stated interest*	*Premium allocable to accrual period*	*Interest income*	*Premium carryforward*
3/1/00	$15,000.00	$870.71	$14,129.29	
3/1/0	0.001	958.81	0.00	958.81
3/1/02	0.00	1,055.82	0.00	2,014.63
3/1/03	10,000.00	1,162.64	6,822.73	
3/1/04	8,000.00	1,280.27	6,719.73	
3/1/05	12,000.00	1,409.80	10,590.20	
3/1/06	15,000.00	1,552.44	13,447.56	
3/1/07	8,500.00	1,709.51	6,790.49	
		$10,000.00		

Example 2. Partial call that results in a pro-rata prepayment—(i) *Facts.* On April 1, 1999, M purchases for $110,000 N's taxable bond maturing on April 1, 2006, with a stated principal amount of $100,000, payable at maturity. The bond provides for unconditional payments of interest of $10,000, payable on April 1 of each year. N has the option to call all or part of the bond on April 1, 2001, at a 5 percent premium over the principal amount. M uses the cash receipts and disbursements method of accounting.

(ii) *Determination of yield and the remaining payment schedule.* M's yield determined without regard to the call option is 8.07 percent, compounded annually. M's yield determined by assuming N exercises its call option is 6.89 percent, compounded annually. Under paragraph (b)(4)(ii)(A) of this section, it is assumed N will not exercise the call option because exercising the option would minimize M's yield. Thus, for purposes of determining and amortizing bond premium, the bond is assumed to be a seven-year bond with a single principal payment at maturity of $100,000.

(iii) *Amount of bond premium.* The interest payments on the bond are qualified stated interest. Therefore, the sum of all amounts payable on the bond (other than the interest payments) is $100,000. Under § 1.171–1, the amount of bond premium is $10,000 ($110,000 – $100,000).

(iv) *Bond premium allocable to the first two accrual periods.* For the accrual period ending on April 1, 2000, M includes in income $8,881.83, the qualified stated interest allocable to the period ($10,000) offset with bond premium allocable to the period ($1,118.17). The adjusted acquisition price on April 1, 2000, is $108,881.83 ($110,000 – $1,118.17). For the accrual period ending on April 1, 2001, M includes in income $8,791.54, the qualified stated interest allocable to the period ($10,000) offset with bond premium allocable to the period ($1,208.46). The adjusted acquisition price on April 1, 2001, is $107,673.37 ($108,881.83 – $1,208.46).

(v) *Partial call.* Assume N calls one-half of M's bond for $52,500 on April 1, 2001. Because it was assumed the call would not be exercised, the call is a change in circumstances. However, the partial call is also a pro-rata prepayment within the meaning of § 1.1275–2(f)(2). As a result, the call is treated as a retirement of one-half of the bond. Under paragraph (b)(5)(ii) of this section, M may deduct $1,336.68, the excess of its adjusted acquisition price in the retired portion of the bond ($107,673.37/2, or $53,836.68) over the amount received on redemption ($52,500). M's adjusted basis in the portion of the bond that remains outstanding is $53,836.68 ($107,673.37 – $53,836.68).

§ 1.171–4 Election to amortize bond premium on taxable bonds.

(a) *Time and manner of making the election*—(1) *In general.* A holder makes the election to amortize bond premium by offsetting interest income with bond premium in the holder's timely filed federal income tax return for the first taxable year to which the holder desires the election to apply. The holder should attach to the return a statement that the holder is making the election under this section.

(2) *Coordination with OID election.* If a holder makes an election under § 1.1272–3 for a bond with bond premium, the holder is deemed to have made the election under this section.

(b) *Scope of election.* The election under this section applies to all taxable bonds held during or after the taxable year for which the election is made.

(c) *Election to amortize made in a subsequent taxable year*—(1) *In general.* If a holder elects to amortize bond premium and holds a taxable bond acquired before the taxable year for which the election is made, the holder may not amortize amounts that would have been amortized in prior taxable years had an election been in effect for those prior years.

(2) *Example.* The following example illustrates the rule of this paragraph (c).

Example—(i) *Facts.* On May 1, 1999, C purchases for $130,000 a taxable bond maturing on May 1, 2006, with a stated principal amount of $100,000, payable at maturity. The bond provides for unconditional payments of interest of $15,000, payable on May 1 of each year. C uses the cash receipts and disbursements method of accounting and the calendar year as its taxable year. C has not previously elected to amortize bond premium, but does so for 2002.

(ii) *Amount to amortize.* C's basis for determining loss on the sale or exchange of the bond is $130,000. Thus, under § 1.171–1, the amount of bond premium is $30,000. Under § 1.171–2, if a bond premium election were in effect for the prior taxable years, C would have amortized $3,257.44 of bond premium on May 1, 2000, and $3,551.68 of bond premium on May 1, 2001, based on annual accrual periods ending on May 1. Thus, for 2002 and future years to which the election applies, C may amortize only $23,190.88 ($30,000 – $3,257.44 – $3,551.68).

(d) *Revocation of election.* The election under this section may not be revoked unless approved by the Commissioner.

Par. 6. Section 1.171–5 is added to read as follows:

§ 1.171–5 Effective date and transition rules.

(a) *Effective date*—(1) *In general.* This section and §§ 1.171–1 through 1.171–4 apply to bonds acquired on or after the date 60 days after the date final regulations are published in the **Federal Register.** However, if a holder makes the election under § 1.171–4 for the taxable year containing the date 60 days after the date final regulations are published in the **Federal Register**, this section and §§ 1.171–1 through 1.171–4 apply to bonds held on or after the first day of that taxable year.

(2) *Transition rule for use of constant yield.* Notwithstanding paragraph (a)(1) of this section, § 1.171–2(a)(3) (providing that the bond premium allocable to an accrual period is determined with reference to a constant yield) does not apply to a bond issued before September 28, 1985.

(b) *Coordination with existing election.* A holder is deemed to have made the election under § 1.171–4 if the holder elected to amortize bond premium under section 171 and that election is effective on the date 60 days after the date final regulations are published in the **Federal Register.**

(c) *Accounting method changes*—(1) *Consent to change.* A holder required to change its method of accounting for bond premium to comply with §§ 1.171–1 through 1.171–3 must secure the consent of the Commissioner in accordance with the requirements of § 1.446–1(e). Paragraph (c)(2) of this section provides the Commissioner's au-

tomatic consent for certain changes. A holder making the election does not need the Commissioner's consent.

(2) *Automatic consent.* The Commissioner grants consent for a holder to change its method of accounting for bond premium with respect to bonds to which §§ 1.171–1 through 1.171–3 apply. The consent granted by this paragraph (c)(2) applies provided—

(i) The holder elected to amortize bond premium under section 171 for a taxable year prior to the taxable year containing the date 60 days after the date final regulations are published in the **Federal Register** and that election has not been revoked;

(ii) The change is made for the first taxable year for which the holder must account for a bond under §§ 1.171–1 through 1.171–3; and

(iii) The holder attaches to its return for the taxable year containing the change a statement that it has changed its method of accounting under this section.

Par. 7. Section 1.1016–5 is amended by revising paragraph (b) to read as follows:

§ 1.1016–5 Miscellaneous adjustments to basis.

* * * * *

(b) *Amortizable bond premium.* A holder's basis in a bond is reduced by the amount of bond premium used to offset qualified stated interest income under § 1.171–2. This reduction occurs when the holder takes the qualified stated interest into account under the holder's regular method of accounting. In addition, a holder's basis in a taxable bond is reduced by the amount of bond premium allowed as a deduction under § 1.171–3(b)(5)(ii) (relating to the issuer's call of a taxable bond).

* * * * *

§ 1.1016–9 [Removed]

Par. 8. Section 1.1016–9 is removed.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Reigster on June 26, 1996, 8:45 a.m., and published in the issue of the Federal Register for June 27, 1996, 61 F.R. 33396)

Foundations Status of Certain Organizations

Announcement 96–68

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Aata-Harry Roswell Foundation, Washington, DC
Act III Inc., Loudon, TN
Adullam Christian Center Inc., Tampa, FL
Aerie East Environmental Foundation, Farmington, ME
African American Atelier Inc., Greensboro, NC
Africa Relief Program Inc., Camden, NJ
Amazon Outreach Inc., West Palm Beach, FL
American Association of Parents and Children Inc., Herndon, VA
American Cultural Exchange, Manchester, MO
American Friends of Talmud Torah Kiryat Herzog, Chicago, IL
Americas Prayer Network Inc., Bethesda, MD
Andrew J. Rendos III Memorial, Monessen, PA
Anita K. Weber Memorial Scholarship Fund, Maplewood, NJ
Annie Malone Childrens Home Expansion Fund Poro Inc., St. Louis, MO
Antique and Garden Show of Nashville Inc., Nashville, TN
Apollo Players Inc., Sterling, IL
Arkansas Scottish Rite Dyslexia Training Center Inc., Little Rock, AR
Arkansas Spinal Cord Injury Assoc. Inc., Little Rock, AR
Army of the Lord Rehabilitation Center Inc., Dania, FL
Arts Council of Cookeville Inc., Cookeville, TN
Asheville Trolley Development Company Inc., Asheville, NC
Bag Pipes and Drums Emerald Society Chicago Police Dept., Chicago, IL
Berkmar High School Band Booster Club, Lilburn, GA
Bible Believers Press Inc., Pensacola, FL
Burlington County Council on Alcohol and Drug Abuse, Mt. Holly, NJ
Camp WE-LO-LON-NAN-NAI, Springville, UT
Center for Human Development Inc., Nashville, TN
Central Area Job Placement Center Inc., Atlanta, GA
Charity Research Services, Raleigh, NC
Chicago Cardiology Group, Wheaton, IL
Chicago Association of Musicians and Songwriters, Maywood, IL
Chicagoland Blind Athletic Association Inc., Chicago, IL
Childrens Fund Inc., Alton, IL
Childrens Neuroblastoma Cancer Fund Inc., Tequesta, FL
Childrens Pathfinder Fund Inc., Grand Rapids, MN
China Crisis Institute, Chicago, IL
Christs Way Bible Church and Ministries, Chicago, IL
Citizens Chamber Foundation, Lufkin, TX
Coalition of Southern Black Youth Inc., Brunswick, GA
Companionship at Home Foundation, Glenwood, IA
Czecho-Slovak Civic Forum Foundation Inc., Washington, DC
Daniel Boone Baseball Association, St. Charles, MO
Educational Endowment for Health Services Inc., Kansas City, MO
Educational Resources Inc., Overland Park, KS
Edward Morris Theatre Company, Hendersonville, TN
Elk River Rails-To-Trails Foundation Inc., Charleston, WV
Freedom Foundation of North Dakota Inc., Bismarck, ND
Friends of The Netherlands Inc., Miami, FL
Greater Cedar Rapids Junior Golf Association, Cedar Rapids, IA
Greater Roseland Area Planning Commission Inc., Chicago, IL
HELP Homeless Elimination Project, Kansas City, MO
HOW Incorporated, Toledo, OH
Illinois Caucus for Foster Children Inc., Chicago, IL
Independence Animal Activists Network, Sioux Falls, SD
International Tax Forum, Chicago, IL
Jazz in Joplin Inc., Joplin, MO
John J. Lamm Ministries, Inc., Euless, TX
Johnson County Area Council on Child Abuse & Neglect, Iowa City, IA
Kent Foundation for Environmental Research and Education, Kent, OH
Kids Sake, West Des Moines, IA

LIHI Group, Watertown, SD
Love of Life Foundation, Greyslake, IL
Masters Management Corp., San Antonio, TX
Maternal Child Care Consortium, St. Louis, MO
Midwest Guide Dogs, Inc., Duluth, MN
Mille Lacs Coalition Against Abuse, Onamia, MN
Missouri Legends Productions Inc., Kansas City, MO
New Democratic Perspective, Silver Spring, MD
New Legends, Philadelphia, PA
Operation Earth Inc., Orlando, FL
Operation Unite-Save the Youth, Chicago, IL
Partners in Placement Inc., Memphis, TN
Partnership for a Drug Free Iowa Inc., Des Moines, IA
Piecemaker Quilt Guild of Brandon, Tampa, FL
Plus Charities, Cedar Rapids, IA
Porsche Youth Action Group Inc., Shawnee Mission, MO
Prince Hall African Lodge Urban Renewal Corp., Newark, NJ
Project Now Inc., Trenton, NJ
Pulse of Louisiana, Baton Rouge, LA
Ralph and Della Haskett Memorial, Jasper, AL
Reach Out for Help Inc., Chicago, IL
Recovery Housing, Inc., Knoxville, TN
Recycling Our Human Resources, Omaha, NE
Redeeming Grace Ministries, Inc., Wakinsonville, GA
Religious Adventures Inc., Kreethville, LA
Rick Harvey Ministries Inc., Greenbriar, AR
Romanian-American Foundation Inc., Upper Montclair, NJ
RVDA Education Foundation, Fairfax, VA
Saint Charles County Golden Games Association, St. Peters, MO
Southern Indiana Center for the Arts Inc., Seymour, IN
Southwest Georgia Arts Council, Inc., Americus, GA
Tabb High Tiger Band Parents Association Inc., Tabb, VA
Texas Knights Templar Educational Foundation, Fort Worth, TX
Thema Literary Society, Metairie, LA
Twins Ranch Non-Profit Corporation, New York, NY
Unity United Methodist Church Housing Corporation, Baltimore, MD
Wesser Institute of Ecology Ltd., Almond, NC
Where Golden Eagles Fly Ministries, Inc., Indianapolis, IN
Yellow Bluff Shelter Home, Pine Hill, AL
Youth Education Strategies, Inc., Columbus, GA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Announcement of the Disbarment, Suspension, and Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Bruender, Lawrence	Lesueur, MN	Attorney	Indefinite from April 18, 1996
Pallman, James J.	New Haven, CT	CPA	April 19, 1996 to October 18, 1996
Pribble Jr., William C.	Minneapolis, MN	Attorney	Indefinite from May 1, 1996
Pyburn, Richard E.	Downers Grove, IL	CPA	May 1, 1996 to October 31, 1997
Scalise, James J.	New Britain, CT	Attorney	May 1, 1996 to July 31, 1996
Kieldaisch, Dale W.	Manteno, Il	CPA	May 1, 1996 to October 31, 1996
Ogorek, Charolotte F.	Park Ridge, IL	CPA	May 3, 1996 to July 2, 1996
Korman, Steven B.	Mulford, CT	CPA	May 3, 1996 to February 2, 1997
Myers, Donald L.	Olney, MD	CPA	May 7, 1996 to May 6, 1998
Sharrett, William R.	Paradise, CA	Enrolled Agent	May 8, 1996 to November 7, 1996
Cornwell, Douglas S.	Norwalk, CT	CPA	May 10, 1996 to November 9, 1996
Chang, Sun Kun	McLean, VA	Enrolled Agent	May 13, 1996 to July 12, 1996
Cariveau, Stewart	Minneapolis, MN	CPA	May 30, 1996 to August 29, 1996
Carter, Gary E.	Ashdown, AR	CPA	June 1, 1996 to August 31, 1996
Underwood, Wendell L.	Sedalia, MO	CPA	June 1, 1996 to July 31, 1996
Candiloro, James A.	Glastonbury, CT	CPA	June 1, 1996 to November 30, 1996
Schwartz, Leonard J.	Danbury, CT	Enrolled Agent	June 1, 1996 to February 28, 1997
Forrester, Donald F.	Fairfield, OH	CPA	Indefinite from June 4, 1996
Shade, Stephen E.	Clearwater, FL	Enrolled Agent	June 8, 1996 to May 7, 1997
Woods, James G.	Huntington, CT	CPA	July 1, 1996 to June 30, 1997
Grove, Michael J.	Alliance, Oh	CPA	July 1, 1996 to June 30, 1997
Jenkins, Frank	Montgomery, AL	CPA	July 1, 1996 to December 31, 1996
Brewton III, George W.	Greenville, MS	CPA	July 1, 1996 to September 30, 1996
Fischer, Randall E.	Lombard, IL	CPA	July 1, 1996 to September 30, 1996
Rhoney, Brian	Wheaton, IL	CPA	July 1, 1996 to Decemer 31, 1996
Devereux, Michael J.	Florissant, MO	CPA	July 1, 1996 to March 31, 1997
Cranston, Robert S.	Saugerties, NY	CPA	July 1, 1996 to December 31, 1996
Miller, Dwight W.	Overland Pk, KS	CPA	July 1, 1996 to June 30, 1997
Beck, Clyde E.	Salina, KS	CPA	July 1, 1996 to October 31, 1996
Seal, Ernest E.	Cleveland, MS	CPA	August 1, 1996 to July 31, 1998
Dicker, Joseph W.	Minneapolis, MN	Attorney	August 1, 1996 to October 31, 1996

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Bushta, Patrick C.	Sacramento, CA	CPA	April 18, 1996
Hart, Joel S.	Beaumont, TX	CPA	April 19, 1996
Riggs, Patricia A.	Stockton, CA	Enrolled Agent	April 19, 1996
Hammontree, Richard F.	Ogunquit, ME	CPA	April 27, 1996
Otto, Judith M.	Tucson, AZ	Enrolled Agent	May 18, 1996

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[1]A cumulative list of all Revenue Rulings, Revenue Procedures, Treasury Decisions, etc., published in Internal Revenue Bulletins 1996–1 through 1996–26 will be found in Internal Revenue Bulletin 1996–27, dated July 1, 1996.

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[1]A cumulative finding list for previously published items mentioned in Internal Revenue Bulletins 1996–1 through 1996–26 will be found in Internal Revenue Bulletin 1996–27, dated July 1, 1996.